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Editors-In-Chief:

Lara O. Glaesman
Leonard, Street and Deinard, P.A.
(612) 335-7074
lara.glaesman@leonard.com

John D. Lamey III
Lamey Law Firm P.A.
(651) 209-3550
jlamey@lameylaw.com

Editorial Board:

Mychal Bruggeman
Mackall, Crounse & Moore, PLC
(612) 305-1400
mab@mcmlaw.com

Edwin H. Caldie
Leonard, Street and Deinard, P.A.
(612) 335-1404
ed.caldie@leonard.com

Benjamin J. Court
Messerli & Kramer P.A.
(612) 672-3709
bcourt@messerlikramer.com

Editorial Board (continued):

Daniel M. Eaton
Christensen Law Office PLLC
(612) 823-0188
dan@clawoffice.com

Jessica A. Mitchell
Gray Plant Mooty
(612) 632-3304
jessica.mitchell@gpmlaw.com

Travis Powers
Fafinski Mark & Johnson, P.A.
(952) 224-9754
travis.powers@fmjlaw.com

Rebecca G. Sluss
Oppenheimer, Wolff & Donnelly
(612) 607-7270
rsluss@oppenheimer.com

Kesha Tanabe
Maslon Edelman Borman & Brand, LLP
(612) 672-8342
kesha.tanabe@maslon.com

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SUPREME COURT MEASURES THE WEIGHT OF THE CONSTITUTION AGAINST FEDERAL GRANT OF DECISION MAKING AUTHORITY

In a 5-4 decision, in *Stern v. Marshall*, ___ U.S. ___, 131 S.Ct. 2594 (June 23, 2011) (Roberts, C.J.), the United States Supreme Court issued the latest interpretation of a bankruptcy court's ability to issue a final judgment on a plaintiff's non-core counterclaim. In what has largely, albeit erroneously, been viewed as a reduction of jurisdiction, the court weighed the statutory *authority* granted to a bankruptcy court by 28 U.S.C. § 157(b) against the constitutional ramifications of exercising such authority.

In 1995, petitioner sued respondent in Texas probate court, accusing the latter of fraudulently inducing petitioner's husband to preclude her from receiving a multi-million dollar testamentary gift. After the husband's death, and while the probate action was pending, petitioner filed for bankruptcy protection in the Bankruptcy Court for the Central District of California. The respondent then filed a complaint in the bankruptcy case accusing petitioner of defamation and seeking a declaration that the claim was non-dischargeable. The petitioner then filed a counterclaim asserting tortious interference with her expected testamentary gift. The bankruptcy court entered a final judgment in petitioner's favor, and the Ninth Circuit Court of Appeals eventually reversed, finding that the bankruptcy court lacked authority to enter a final judgment on petitioner's state court, non-core counterclaim. Thus, the Texas state court decision, which ultimately ruled in favor of respondent, was the controlling judgment.

Pursuant to 28 U.S.C. 157(b)(1), a bankruptcy court may enter a final judgment in "core proceedings" in a bankruptcy case. However, absent consent of the litigants, a bankruptcy court may only hear non-core proceedings, and submit findings of fact and conclusions of law to the district court for final determination pursuant to 28 U.S.C. § 157(c)(1) and (2). The court noted at the outset that under the plain language of 28 U.S.C. § 157(b)(2)(C), petitioner's counterclaim was a "core proceeding," as that section explicitly includes "counterclaims by the estate against persons filing claims against the estate" within its statutory definition, thus seemingly granting the bankruptcy court the authority to enter a final judgment. However, serious constitutional concerns arise when summarily delineating all counterclaims as core proceedings. While title 28 of the United States Code allowed the bankruptcy court to enter a final judgment on the petitioner's counterclaim, Article III of the Constitution precluded such action, at least where ruling on respondent's proof of claim would not necessarily resolve the estates counterclaim.

Pulling heavily from the court's 1982 decision in *Northern Pipeline Constr. Co. v. Marathon Pipeline Co.*, 458 U.S. 50 (1982), the court was explicit in that Article III of the Constitution not only protects the well-established principle of separation of powers, but also preserves judicial integrity. And to maintain this integrity, judicial power must not be vested in entities not within the scope of Article III. As was the case in *Northern Pipeline*, the bankruptcy court in this

instance was exercising the judicial power of the United States to finally adjudicate a state common law claim existing independently from the Federal Bankruptcy Code. And as was the case in *Northern Pipeline*, the court found that Article III of the Constitution prevented the bankruptcy court from doing so despite its statutory classification as a core proceeding, as traditional common law actions belong in front of Article III tribunals.

AT LEAST PRIOR TO *STERN V. MARSHALL*, THE BANKRUPTCY COURT MAY ENTER JUDGMENT FOR DEBT IN NON-DISCHARGEABILITY ACTION

In *Islamov v. Ungar* (*In re Svetlana Sergeyevna Ungar*), 633 F.3d 675 (8th Cir., Feb. 14, 2011) (Schermer, J.), a creditor filed an adversary proceeding seeking a determination that investments she made with the debtor are non-dischargeable debts under 11 U.S.C. §§ 523(a)(2)(A) and (a)(6).

The debtor emigrated to the United States from the former Soviet state of Moldava. The creditor emigrated from the former Soviet state of Tajikistan and was unfamiliar with the United States stock markets. Both the debtor and creditor speak Russian, and upon meeting, the debtor informed the creditor that she was a successful day trader. Over the course of several years, the debtor got the creditor to "invest" over $500,000 with her. She falsely reported to the creditor that she was making profits through oral representations, in writing and in spreadsheets that falsely showed an increasing account balance. In reality, the debtor was incurring losses and using the funds for her personal expenses.

After making some payments to the creditor, the debtor filed bankruptcy. The creditor brought an adversary proceeding claiming its losses were non-dischargeable. The bankruptcy court found over $200,000 in losses to the creditor to be non-dischargeable due to fraud under 11 U.S.C. § 523(a)(2)(A) and/or willful and malicious injury under 11 U.S.C. § 523(a)(6). The bankruptcy court also entered judgment against the debtor in that amount.

The debtor appealed, claiming there was no "justifiable reliance" by the creditor on the debtor's representations to establish non-dischargeability under § 523(a)(2)(A) and the bankruptcy court could not enter judgment for the debt itself. The Eighth Circuit held that since the creditor was an unsophisticated investor unfamiliar with American investing, he had justifiably, although perhaps not reasonably, relied on the debtor's representations. Moreover, the debtor used her shared language to build trust and lend credence to her false representations regarding the balance of the account. Further, the court held that the bankruptcy court could not only determine the dischargeability of the debt but could also enter judgment for the amount of the debt itself. Note however that this case was decided prior to *Stern v. Marshall*, ____ U.S. ____,131 S. Ct. 2594 (2011), and there may now be an issue as to whether the bankruptcy court could in fact enter judgment for the debt amount.

EIGHTH CIRCUIT CONFIRMS THAT STATE COURTS HAD CONCURRENT JURISDICTION TO DETERMINE RIGHTS FOLLOWING BANKRUPTCY SALE AND THAT IMPLIED COVENANTS RUNNING WITH LAND ARE NOT EXTINGUISHED IN SUCH A SALE

A purchaser of real property from a bankruptcy estate who acquires land "free and clear" in accordance with a 11 U.S.C. § 363(f) sale is still burdened by certain restrictive covenants that run with the land, according to an order from the Eighth Circuit in *Mid-City Bank v. Skyline Woods Homeowners Ass'n* (*In re Skyline Woods Country Club*), No. 10-2618 (8th Cir., Feb. 22, 2011).

After filing a voluntary chapter 11 petition, debtor filed a motion under 11 U.S.C. § 363 seeking to sell substantially all its assets, including a golf course, pursuant to an asset purchase agreement. The high bid of $2.9 million was submitted by buyer, which the bankruptcy court approved as "in the best interests" of all parties in interest. The court then issued a sales authorization order consistent with 11 U.S.C. § 363(f) authorizing the sale "free and clear" of all mortgages, defects, adverse claims, interests, or liabilities of any kind or nature. The bankruptcy case was then converted to a no-asset chapter 7 liquidation and closed.

Some time thereafter, buyer ceased operating the golf course and began changing the nature and use of the property. Nearby residents and various homeowners associations sued buyer in state court, asserting express and implied restrictive covenants requiring the property to be maintained as a golf course. Buyer responded by filing a motion in the bankruptcy court to enforce the terms of the sales order, which it contended barred the state law claims. However, after the bankruptcy court advised buyer that it must move to reopen and pay a filing fee, buyer withdrew the motion and defended the state court action on the merits. The state court granted summary judgment to the residents and homeowners and the buyer appealed. The Nebraska Supreme Court affirmed, holding that the implied restrictive covenants run with the land and were interests that could not be extinguished under 11 U.S.C. § 363(f).

Buyer then defaulted on its secured loan. When the bank recorded an election to sell the property, the residents and homeowners filed a second state court action seeking to subordinate the bank's mortgage to their equitable lien for the costs of maintaining the property. The bank and buyer then filed a motion to reopen the debtor's bankruptcy and initiate an adversary proceeding to enforce the sales order, void the Nebraska judgment, and enjoin the residents from enforcing it. The bankruptcy court denied the motion, and the BAP affirmed, concluding that, because the Nebraska Supreme Court had concurrent jurisdiction to interpret the sales order, the judgment in the first state court action was entitled to preclusive effect and therefore reopening the bankruptcy case would be futile. The bank and buyer appealed.

The Eighth Circuit affirmed, holding that the state court judgment was entitled to full faith and credit pursuant to 28 U.S.C. § 1738 and rejecting the bank and buyer's claim that the bankruptcy court had exclusive jurisdiction over the

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claims asserted in the first state court action. Because the state court had concurrent jurisdiction to take up the issue, its decision – made after expressly considering the arguments the bank and buyer attempted to raise in the bankruptcy court – would have the same impact in the bankruptcy court as it would in the state courts. As a result the Eighth Circuit stated that the relief sought was futile. The Eighth Circuit also determined that buyer's action in voluntarily withdrawing its earlier motion to reopen served as another reason to deny the bank and buyer's motion as the decision constituted an election to forego their rights in the bankruptcy courts.

THE REDUCTION IN VALUE OF EQUITY WAS NOT SUFFICIENT TO SATISFY THE REQUIREMENT THAT MONEY OR PROPERTY WAS OBTAINED IN A NON-DISCHARGEABILITY PROCEEDING

In *Marcusen v. Glen* (*In re Robert Glen*), 639 F.3d 530 (8th Cir., April 12, 2011) (Wollman, J.), the plaintiffs brought an adversary proceeding claiming that certain construction loan debts were non-dischargeable under 11 U.S.C. § 523(a)(2).

In order to finance the construction of homes in Winona, Minnesota, the plaintiffs advanced funds to the debtors with the understanding that the debtors and plaintiffs would share the profits from home sales. The debtors granted a mortgage on the first lot to the plaintiffs. Although, neither the debtors nor the plaintiffs filed the mortgage, after the first home sold, the plaintiffs received from the debtors the full amount of their investment plus their share of the profits. The plaintiffs subsequently advanced additional funds to the debtors. The debtors granted two mortgages to the plaintiffs for two lots (lot 23 and lot 6). Again, neither the debtors nor the plaintiffs recorded the mortgages. The debtors then obtained additional financing for lot 23 from a local bank. The debtors obtained a construction loan in return for executing a promissory note in favor of the bank secured by a mortgage on lot 23. The bank recorded the mortgage. The debtors never disclosed to the bank that the plaintiffs had an unrecorded mortgage on lot 23. In addition, in order to obtain financing to build another home, the debtors obtained a loan from another new lender in exchange for a promissory note secured by a mortgage on lot 6. Again, the debtors did not disclose to this new lender the plaintiffs' unrecorded mortgage on lot 6. This new lender recorded the mortgage. Lot 23 was then sold and all proceeds went to the bank. Lot 6 was foreclosed upon by the other new lender.

Shortly thereafter, the debtor filed for bankruptcy relief. The plaintiffs filed the adversary case seeking a determination that the loans to the debtors are non-dischargeable. The bankruptcy court agreed, but the BAP reversed. The Eighth Circuit Court of Appeals affirmed the reversal holding that the debtors had not made representations to the plaintiffs at the time the later recorded mortgages were obtained. Further, even if they had, the debtors obtained no money or property from the plaintiffs at the time of these representations. A reduction in value of the plaintiffs' equity was not sufficient to satisfy the requirement that money or property was obtained from the plaintiffs. Any reduction in the value of

the equity to the plaintiffs resulted from their failure to record the mortgage on lots 23 and 6 and not from any conduct by the debtors that could be characterized as fraudulent within the meaning of § 523(a)(2)(A).

BY NOT OBJECTING TO THE DEBTOR'S CHAPTER 13 PLAN, EX-SPOUSE AGREED TO A DIFFERENT TREATMENT OF HER CLAIM

In the case of *Nancy Jo Burnett vs. Clarence Lee Burnett* (*In Re Clarence Lee Burnett*), 09-2871, (8th Cir. July 20, 2011), the debtor Clarence Burnett reopened his chapter 13 bankruptcy so that he could petition the bankruptcy court to hold his ex-wife, Nancy Burnett, in contempt for violating the terms of his confirmed chapter 13 plan by seeking to garnish his wages in an attempt to satisfy child-support and spousal-support arrears.

The divorce decree between the parties stated that Mr. Burnett was to pay "$750.00 per month for child support and alimony until the child reaches the age of eighteen years of age, becomes self-supporting, marries, or dies." Nothing in the decree specified what percentage of the support payment was to go to child support and what percentage was meant for spousal support. Subsequently, Mr. Burnett filed for chapter 13 bankruptcy. At the time of his filing he owed support arrears in the amount of $57,402.70.

The parties litigated the support issue within the bankruptcy court and ultimately the parties reached an agreement which was codified in an order approved by the court, the language of which was then incorporated into the debtor's modified plan. The agreement between the parties was that the debtor would pay $300.00 per month during the life of his plan to be paid toward the arrearage claim, and $300.00 per month after his plan was complete until the claim was satisfied. It also allowed Mrs. Burnett to litigate the issue of accrued interest on the support arrears in state court and for the debtor to raise applicable defenses. Mrs. Burnett did not object to the language in the plan even though when the agreement between the parties was codified in the modified plan, the word "child" had been added to the word "support" designating the arrearage claim of $57,402.70 as "child" support arrearage as opposed to just support arrearage The bankruptcy court confirmed the plan.

The debtor made all of his plan payments and received his discharge after which Mrs. Burnett returned to state court to litigate the support issue. The outcome of the state court hearing, which the debtor did not attend despite receiving notice, was the start of a monthly withholding from the debtor's military pension of $703.45. Instead of appealing the court order, the debtor reopened his bankruptcy case and brought a motion for contempt before the bankruptcy court for violation of his confirmed plan. He argued that Mrs. Burnett could not pursue him for pre-petition interest on spousal support because his plan limited her to seeking only interest on pre-petition child support.

The bankruptcy court held that § 1327(a) applied, as opposed to § 1322(a)(2), because the debtor's plan was confirmed. Section 1327 states that the effect of confirmation is to "bind the debtor and each creditor" to the

provisions of the plan. Thus, since the language in the confirmed plan provided that Mrs. Burnett could litigate only the issue of interest on her child support arrearage, it acted to bar her from seeking recovery of interest on her pre-petition spousal support. However, with regard to any post-petition domestic support obligations and any post-petition interest, the court agreed with the BAP that Mrs. Burnett could seek recovery of these amounts, as they were not provided for by the debtor's plan.

DEBT COUNSELING FEE PAID BY DEBTOR PRIOR TO PETITION DATE NOT A FRAUDULENT TRANSFER EVEN IF COUNSELING DID NOT HELP DEBTOR TO AVOID A BANKRUPTCY FILING

In *Kaler v. Able Debt Settlement, Inc. (In re Grant A. Kendall and Andrea L. Kendall)*, No. 10-6056 (8th Cir. BAP, December 9, 2010), the BAP held that debtors' payments to a debt settlement service, during the time the debtors were insolvent, were not fraudulent transfers pursuant to 11 U.S.C. § 548(a)(1)(B).

The debtors entered into a contract with Able Debt Settlement for debt settlement services notwithstanding the fact that Able Debt Settlement's initial review of the debtor's financial situation arguably showed that the debtors had a negative monthly disposable income and could not successfully implement a debt reduction plan created by Able Debt Settlement. The debtors terminated the agreement with Able Debt Settlement once their financial situation deteriorated further and filed for bankruptcy under chapter 7. The chapter 7 Trustee then filed an action seeking to recover $1,708.37 in service fees paid to Able Debt Settlement as a fraudulent transfer under the Bankruptcy Code's constructive fraud provision, Section 548(a)(1)(B). The court held that the service fees were not fraudulent transfers.

On appeal, the trustee argued that the value of the fees was not reasonably equivalent to the services provided by Able Debt Settlement because there was no possibility that the debtors would avoid bankruptcy by participating in the program. The court asserted that a determination of reasonably equivalent value would turn on whether the debtors received a fair exchange in the market place for the goods transferred. The fact that avoiding bankruptcy under Able Debt Settlement's plan may have been impossible did not bear on whether the debtors received fair value. The Court held that so long as there is some chance that a contemplated investment will generate a positive return at the time of the disputed transfer, value has been conferred. The BAP held that the court did not err in finding that Able Debt Settlement was entitled to retain service fees paid up until the time of debtors' chapter 7 filing.

BANKRUPTCY APPELLATE PANEL FOLLOWS STRICT INTERPRETATION OF MISSOURI STATE HOMESTEAD EXEMPTION STATUTE

In *Moon v. Hurd (In re Hurd)*, No. 10-6072 (8th Cir. BAP, Dec. 15, 2010), the chapter 7 trustee appealed an order of the bankruptcy court for the Western District of Missouri allowing the debtor a homestead exemption for his 1997 Wrangler Gooseneck 2 horse trailer.

On April 7, 2010, the debtor filed a chapter 7 petition, listing the trailer on his schedule of personal property, and assigning it a value of $3,000. Additionally, the debtor claimed the entire $3,000 as exempt pursuant to section 513.430.1(6) of the revised Missouri statutes, which exempts the value of "any mobile home used as the principal residence but not on or attached to real property in which the debtor has a fee interest, not to exceed five thousand dollars in value . . . ." MO. REV. STAT. § 513.430.1(6). According to the debtor, the twenty by six foot trailer rested on the real property of a close friend, the debtor received mail at the physical address listed for the real property, the trailer was transported by way of the debtor's pickup truck and the debtor used the trailer as his personal residence from 2008 to the present time.

The trustee, asserting that the debtor resided primarily at his girlfriend's house for the 12 months preceding the chapter 7 petition, objected to the claimed exemption. Additionally, the trustee claimed that the trailer did not meet the specific physical requirements of a homestead exemption under section 513.430.1(6). Despite the trustee's objection, the bankruptcy court granted the debtor his asserted exemption, stating that such exemptions should be liberally construed and the trailer was appropriately modified to operate as the debtor's principal residence. In response, the trustee appealed to the BAP, renewing his assertion that the trailer did not meet the requirements for a homestead exemption.

Initially, the BAP noted that as an "opt out" state, the scope of the debtor's claimed exemptions were determined by Missouri state law rather than federal bankruptcy law. *See* 11 U.S.C. § 522(b). Next, the BAP took to an interpretation of Missouri's homestead exemption statute, determining that the trustee was correct that the trailer failed to meet the required specifications. As noted, section 513.430.1(6) exempts the value, up to $5,000, of a mobile home used as a debtor's principal residence. However, the Missouri statute fails to define the term "mobile home." Therefore, the court analogized the trailer to a "manufactured home," which Missouri statutes section 700.010(6) defines as a certain structure measuring "eight body feet or more in width or forty body feet or more in length, or, when erected on site, contains three hundred twenty or more square feet . . . ." MO. REV. STAT. § 700.010(6). Additionally, the BAP noted that analogizing a "mobile home" to a "manufactured home" was proper, as the title of chapter 700 is "Manufactured Homes (Mobile Homes)."

In reversing the decision of the bankruptcy court, the BAP determined that the trailer failed to qualify under any option specified in section 700.010(6), as it was only six feet in width, 20 feet in length, and 120 total square feet. Therefore, the trailer did not meet the technical specifications of section 513.430.1(6), as supplemented by section 700.010(6), and did not qualify the debtor for a homestead exemption in the trailer.

MONTHLY MAINTENANCE PAYMENTS AND ATTORNEY'S FEES PURSUANT TO A STATE COURT MARRIAGE DISSOLUTION PROCEEDING ARE EXCEPTED FROM DISCHARGE

In the case of *Sheri L. Phegley vs. John Joseph Phegley* (*In Re John Phegley*), 10-6063, (8th Cir. BAP, Jan. 25, 2011), the debtor appealed the bankruptcy court's order determining that the debts to his ex-spouse in the nature of monthly maintenance payments and attorney's fees, pursuant to his state court marriage dissolution proceeding, were excepted from discharge pursuant to § 523(a)(5). The parties' divorce decree ordered the debtor to pay $1,250 per month for spousal maintenance, and a portion of his ex-spouse's attorney's fees. The debtor claimed that the debts were not support obligations, but rather were a division of marital property and should not be excepted from discharge.

The debtor filed a chapter 13 bankruptcy. If the debts to his ex-spouse met the definition of domestic support obligations as defined in § 523(a)(5), they would not be excepted from his chapter 13 discharge. See, § 1328(a). Domestic support obligations are defined in § 101(14A)(B) as alimony, maintenance, or support payments.

The BAP cited the following factors taken into consideration when making the determination as to whether the debts were domestic support obligations: (i) the language and substance of the agreement in the context of the surrounding circumstances; (ii) the financial conditions of the parties at the time of the divorce; (iii) the employment histories and prospects for financial support; (iv) the allocation of the marital property; (v) the periodic nature of the payments; and (vi) whether it would be difficult for the former spouse and children to subsist without the payments.

The bankruptcy court found that these factors weighed in favor of the payments having been awarded by the family court for the support of the debtor's ex-spouse. Furthermore, the language in the divorce decree specifically held that the monthly maintenance payments were necessary for the debtor's ex-spouse to continue her education so that she may be able to support herself. All of these considerations led the bankruptcy court to hold that the maintenance payments were domestic support obligations and as such, excepted from discharge. The BAP found that this holding was supported by the record and affirmed the bankruptcy court's holding. The BAP also upheld the bankruptcy court's finding that the payment of the attorney's fees by the debtor was meant to make up for disparities in the parties' education, employment history, and earning capacity, making it intended as a support payment and excepted from discharge as well.

DEBTOR'S OVERSTATEMENTS ON FINANCIAL RECORDS, FAILURE TO VERIFY LIABILITIES, AND PERSONAL USE OF COLLATERAL RENDERS DEBT TO LENDER NONDISCHARGEABLE PURSUANT TO 11 U.S.C. § 523(A)(2)(A) AND (B)

In *Southeast Nebraska Coop. Corp. v. Schnuelle* (*In re Schnuelle*), No. 10-6026 (8th Cir. BAP, Jan. 27, 2011), lender filed a complaint against debtor and his wife pursuant to 11 U.S.C. § 523(a)(2)(A) and (B) to determine the

dischargeability of its claim. At the beginning of the trial, lender dismissed its complaint against debtor's wife. Following trial, the bankruptcy court entered judgment in favor of lender, determining lender's claim against debtor was excepted from discharge pursuant to § 523(a)(2)(A) and (B). The bankruptcy court denied debtor's motion to reconsider, and debtor appealed. The BAP affirmed.

The Debtor is a cattle and grain farmer. In 2004 and 2005, debtor borrowed money from lender used to put in his crops. Before making the loan, lender required debtor to provide a financial statement and a collateral worksheet that included information regarding debtor's multiple peril crop insurance coverage. Lender's lending policies were designed to ensure that it had the first lien position on that year's crop and the borrower had sufficient crop insurance to protect lender's investment.

At trial, debtor admitted the documents he submitted to lender were inaccurate and that he had overstated the amount of crop insurance he had in both 2004 and 2005 by 25%. The lender did not learn of the errors in the 2005 documents until after most of the 2005 crop year funds had been advanced to the debtor, and it did not learn of the errors in the 2004 documents until the debtor's bankruptcy. The debtor attempted to explain the errors by stating he relied on lender's employees to put in the correct numbers and he signed the documents without reading them. Additionally, although the debtor understood that the lender had a first lien position in his 2004 and 2005 corn crops, he fed an undetermined amount of his 2004 crop and more than 14,000 bushels of his 2005 crop to his cattle. The debtor did not first discuss this with or obtain permission from the lender and failed to provide the lender with replacement liens in other assets for the value of the corn he fed to the cattle.

Further, at the lender's request, in early 2005 the debtor signed an affidavit regarding collection actions that had been commenced against him. Among other things, the affidavit contained a clause requiring the debtor to advise the lender of any collection actions that were filed against him in the future. The debtor failed to advise lender of several lawsuits that were commenced against him and several money judgments that were obtained against him after he signed the affidavit.

In the summer of 2005, the debtor sought additional funding from lender. In support of his request, the debtor's other primary funding source sent the lender a letter regarding certain income the debtor claimed he would receive in the near future that could be used to repay the lender. The lender sent the debtor the money, but the debtor did not receive all of the promised income and only repaid a small portion of the new loan. Thereafter, the debtor filed a petition for relief pursuant to the bankruptcy code.

The BAP affirmed, holding that lender established actual fraud through circumstantial evidence of the debtor's intent to deceive lender, the debtor's silence when it knew the amount lender was providing was directly related to the projected dollar value of the crops, and the lender's lack of knowledge as to how debtor was intending to feed his cattle. The BAP also affirmed judgment in favor of lender pursuant to § 523(a)(2)(B), holding that the debtor's misstatements on the balance sheets

regarding pending liabilities were material because of the size of the omitted liabilities, the nature of those liabilities, and their impact on the balance sheets' portrayal of debtor's financial health. The BAP held that the lender reasonably relied on the balance sheets and collateral worksheets to its detriment, even though the crop yield figures on the collateral worksheets were greater than in prior years and the debtor's liabilities were understated. Finally, the BAP ruled that the bankruptcy court correctly found that debtor acted with reckless indifference or reckless disregard for lender when he provided only estimated, not actual, figures and failed to contact creditors to determine his actual liabilities.

WHERE INDIVIDUAL CHAPTER 11 DEBTOR SOLICITED FRAUDULENT INVESTMENTS, DEBTOR'S PLAN NOT PROPOSED IN GOOD FAITH AND DEBTOR NOT ENTITLED TO DISCHARGE

The case of *Reuter v. Cutcliff* (*In re Reuter*), No. 10-6043 (8th Cir. BAP, January 31, 2011) involved a non-discharge action and chapter 11 plan objection against a debtor who assisted in soliciting fraudulent investments and selling unregistered securities. The plaintiffs represented investors to whom Reuter had directly solicited investments through Vertical Group, LLC. The securities sold were unregistered and part of a fraudulent scheme against the investors, which plaintiffs alleged was a Ponzi-scheme. The federal authorities convicted one of the principals of the Vertical Group, Daryl Brown, on seven counts of wire fraud and various other federal crimes. When Reuter sought to file a chapter 11 bankruptcy, several investors objected to his discharge under 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(19), as well as objected to his plan. The bankruptcy court ruled for the investors in denying the discharge and also found that the debtor had not proposed the plan in good faith, but rather as a means to evade, defeat and minimize the investors' state court lawsuits. The court also found that the chapter 11 plan did not propose to include various property the debtor had transferred to a trust, and that property would be available in a chapter 7 proceeding which, when liquidated and distributed to the investors, would provide a better return than under the plan.

On appeal, the debtor appeared to challenge virtually every legal finding the bankruptcy court made. The BAP upheld a variety of points with little discussion. The salient points of the appeal involved the 523(a)(19) holding and the holding that the debtor's discharge could be denied based on his vicarious liability for the fraud of the company and its criminally-convicted principal. The debtor argued that the company and Brown were the "sellers" under state securities laws, not the debtor, and that debtor was not an active partner with Brown – essentially suggesting he was ignorant of the activities, and could not be liable for the fraud of his superior.

The court rejected the debtor's arguments. On the first point, the bankruptcy court found that the debtor's direct interactions with the investors established that he was a seller under state law. His admission that the securities were unregistered further established a violation of a state securities law to establish liability under Section 523(a)(19). On the second

point, the bankruptcy court found that the debtor had "willfully ignored the warning signs about Mr. Brown and either knew of or should have known of Mr. Brown's fraud." The BAP would not disturb that finding. Thus, the case was distinguishable from *Treadwell v. Glenstone Lodge, Inc. (In re Treadwell)*, where the court relieved a debtor for the fraud of his spouse, when the debtor was an ownership partner in her travel agency but the record showed he did not participate in any way in the fraud or even in the business or its financial aspects of his wife's company.

BANK'S FAILURE TO DEMONSTRATE REASONABLE RELIANCE ON DEBTOR'S PERSONAL FINANCIAL STATEMENT PRECLUDED AN ORDER OF DISCHARGEABILITY PURSUANT TO 11 U.S.C. § 523(A)(2)(B)

In *Northland National Bank v. Lindsey* (*In re Lindsey*), No. 10-6045 (8th Cir. BAP, Feb. 8, 2011), David P. Lindsey, the debtor, and his wife formed a corporation to operate a home improvement consulting and sales business in 1985. In 2005, the debtor and his wife transferred certain gold coins they owned to capitalize the corporation.

Two months before transferring the coins, the debtor and a third party formed a separate corporation to operate a wholesale construction supply company business. A short time after the coin transfer, the new entity sought and obtained a $750,000 loan from the bank. The debtor personally guaranteed the loan, and he and his wife (who did not personally guaranty the loan) submitted a personal financial statement. On it, they listed coins valued at $125,000 and mutual funds valued at $150,000. The statement failed to identify specifically who owned the coins and whether they were encumbered.

In 2008, the bank renewed the loan and in conjunction therewith, the debtor and his wife submitted a second personal financial statement, which identified coins valued at $160,000 and mutual funds valued at $140,000. No information concerning the ownership of the coins or mutual funds was requested or provided. Later that year, the bank released a second mortgage it held on debtor's home, which secured, in part, the bank's loan. In exchange, debtor pledged a certificate of deposit. Debtor did not submit any additional personal financial statements.

In 2009, the debtor and the third party shut down the construction supply business, leaving a $170,000 debt to the bank, for which the debtor was liable pursuant to his personal guaranty. Approximately two months after closing down the business, the debtor filed for relief under chapter 7 of the bankruptcy code. The bank filed an adversary proceeding, objecting to the debtor's discharge pursuant to 11 U.S.C. § 727(a)(2), (3), (4) and (5) and seeking a determination as to the dischargeability of the bank's claim pursuant to 11 U.S.C. § 523(a)(2)(A) and (B), (4) and (6). The bank's complaint also contained additional counts for breach of contract, unjust enrichment, fraud and intentional misrepresentation, conversion, corporate piercing/alter ego, and transfers in fraud. The bankruptcy court found in favor of the debtor and the bank appealed whether its claim was

dischargeable pursuant to 11 U.S.C. § 523(a)(2)(B).

The BAP affirmed, holding the bank failed to sustain its burden of proof because the bank did not establish that the debtor's representations concerning ownership of the coins were materially false as the debtor and his wife controlled the entity they contributed the coins to and therefore had de facto control of them. As for the liquidity of the mutual funds, although they were part of the wife's self-employed pension plan, the BAP determined there was no dispute the funds were nevertheless available to the debtor and his wife.

More significantly, the BAP ruled that the bank did not reasonably rely on debtor's representations as it did not rely on them at all. Instead, the evidence established that the bank relied on its longstanding history with the debtor, the debtor's track record of paying his debts, his good credit report, and his good relationship with the bank in order to make the loan. Finally, the BAP determined that the bank failed to establish the debtor's intent to deceive, as the debtor accurately disclosed all assets and liabilities on his personal financial statement, including his debts to other banks to whom he also pledged the coins as collateral.

DEBTORS CANNOT AVOID THE CHAPTER 7 ABUSIVE FILING FACTORS OF § 707(B)(1) BY FILING IN CHAPTER 13 AND CONVERTING TO CHAPTER 7

In *Fokkena v. Chapman and Chapman (In re Damian Gerald Chapman, et al.)* No. 10-6046 on appeal from the Bankruptcy Court for the District of Minnesota and *Fokkena v. Cruse (In re Cruse)* No. 10-6047 on appeal from the Bankruptcy Court for the Southern District of Iowa (8th Cir. BAP, March 11, 2011), the BAP held that a debtor's bankruptcy case, originally filed under chapter 13, can be dismissed as an abuse under 11 U.S.C. § 707(b)(1).

In both cases, the debtors originally filed chapter 13 bankruptcy cases and failed to make the required payments under their plans. The debtors converted their cases to chapter 7, and the trustee for both cases moved to dismiss under § 707(b). The district courts of Minnesota and the Southern District of Iowa both denied the trustee's motions to dismiss finding that § 707(b)(1) does not apply to cases not originally filed as chapter 7, but instead converted from chapter 13. Although, the BAP restated the law in the 8th Circuit that orders denying dismissal under § 707(b) are appealable, it acknowledged a disagreement among the bankruptcy courts regarding interpretation of § 707(b)(1) and dismissing cases that originated as chapter 13 cases.

Some courts read the words of § 707(b)(1), "the court, … may dismiss a case filed by an individual debtor under this chapter" to mean that a debtor must originally file under chapter 7 for this provision to have effect. These courts reason that if Congress wanted to refer to converted cases in this section it would have done so. Other courts, however, note that if § 707(b)(1) does not apply to converted chapter 13 cases, then debtors could use this loophole to file cases in chapter 13 and then convert to chapter 7 to avoid the protections of § 707(b)(1). Most importantly, *Resendez v. Lindquiest*, 691 F.2d 397 (8th Cir. 1982), a controlling 8th Circuit case, held that chapter 13 cases that are

converted to chapter 7 cases are considered to be filed under chapter 7 when interpreting § 707(b)(1). Because *Resendez* controls, the BAP in this case holds that § 707(b)(1) applies to chapter 13 cases that convert to chapter 7 cases, and therefore reversed the decisions of the bankruptcy courts and remanded the cases for determination of dismissal under §§ 707(b)(2) and (3).

What was not a part of the BAP's analysis was the fact that in both cases the debtor's circumstances changed between the chapter 13 filing and conversion to chapter 7 (one debtor's financial circumstances deteriorated and the other debtor's circumstances improved). The BAP's decision does not state at what point in time the abuse provisions of § 707 (the means test, bad faith, and totality of the circumstances) should be applied when a case converts from chapter 13 to chapter 7. In both cases, this determination could make a big difference when the bankruptcy courts analyze dismissal under §§ 707(b)(2) and (3).

WHERE A DEBTOR HAD TWO CASES DISMISSED IN THE PREVIOUS YEAR, AND THAT DEBTOR THEN FILES ANOTHER NEW BANKRUPTCY PETITION, THE AUTOMATIC STAY NEVER GOES INTO EFFECT

In the case *In re Bates*, 10-6084 (8th Cir. BAP, March 23, 2011) (C.J. Kressel, J. Saladino, and J. Nail), the BAP affirmed the denial of a debtor's motion for reconsideration. The debtor's motion sought to have the lower court reconsider its vacation of an earlier order that granted the debtor's motion to cancel a foreclosure sale.

The debtor in the *In re Bates* case filed a chapter 13 petition on July 21, 2008. The debtor's case was dismissed due to her failure to make plan payments on June 15, 2009. The debtor then filed a chapter 7 petition on July 10, 2009, and she received a discharge on October 26, 2009. The debtor then filed another chapter 13 petition on December 31, 2009, which was dismissed on January 21, 2010, due to the debtor's failure to complete her schedules. On January 22, 2010, the bankruptcy court reinstated the debtor's case, but the case was ultimately dismissed again on March 11, 2010, this time due to the debtor's failure to list her previous bankruptcy filing on her petition. Finally, the debtor filed another chapter 13 petition on May 20, 2010, in which she failed to mention her December 31, 2009 filing.

On October 28, 2010, the debtor filed a motion to cancel a pending foreclosure sale, and the court granted the debtor's motion on November 1, 2010. On November 3, 2010, however, the court issued an order *sua sponte* vacating its earlier order pursuant to 11 U.S.C. § 362(c)(4)(A)(i). In its November 3, 2010 order, the bankruptcy court explained that the debtor was not entitled to the relief she sought in her October 28, 2010 motion due to her multiple bankruptcy filings. The debtor then filed a motion asking the bankruptcy court to reconsider its November 3, 2010 order. The court denied the debtor's motion for reconsideration and the debtor appealed.

The BAP resolved the debtor's appeal by reference to the unambiguous language contained in 11 U.S.C. § 362(c)(4)(A)(i). Specifically, the BAP held that, "where a debtor has had two or more cases pending within the previous year that were dismissed, and neither was a case

refiled under a chapter other than chapter 7 after dismissal … the automatic stay under § 362(a) never goes into effect." In addition, the Bankruptcy Appellate Panel further held that, under this rule, the automatic stay is equally inapplicable to the debtor and to property of the debtor's bankruptcy estate.

BANKRUPTCY APPELLANTS MUST PROVIDE AN ADEQUATE RECORD OF THE CHALLENGED DECISION(S) BELOW AND MUST OBJECT IN THE FIRST INSTANCE TO MOTIONS UNDERLYING THE APPEALED DECISIONS

In the case *In re Brown*, 10-6087 (8th Cir. BAP, April 5, 2011) (J. Federman, J. Venters, and J. Nail), the BAP affirmed orders of the bankruptcy court: (i) denying confirmation of the debtor's chapter 13 plan; (ii) granting a creditor's motion for relief from stay; and (iii) granting the chapter 13 trustee's motion to dismiss. The BAP did not analyze the substance of the debtor's appeal, but instead affirmed the bankruptcy court's orders on the basis of well-established principles of appellate jurisprudence. Specifically, the BAP affirmed the order denying confirmation because the debtor failed to provide an adequate record of that decision, and the BAP refused to consider any challenge to the orders granting relief from the stay and dismissal because the debtor failed to object to those motions in the bankruptcy court.

JUDGMENT CREDITOR MAY INCLUDE POST-JUDGMENT INTEREST IN PROOF OF CLAIM WHEN INTEREST IS PERMITTED BY STATE LAW

In *In re Edwards*, 446 B.R. 276 (8th Cir. BAP, April 12, 2011) the debtors included a judgment debt in their 2009 chapter 13 bankruptcy filing. In 2002, a Missouri state court ordered the debtors to "demolish, destroy or remove" a pond and restore a stream bed to the conditions that existed prior to the debtors' construction of the pond. If they failed to comply, the debtors were to pay the creditor a penalty of $50 per day. The debtors appealed, but the state appellate court affirmed the judgment in 2003. In 2004, the state court found the debtors in contempt of the court order and ordered that the debtors pay the $50-per-day penalty. In 2007, the state court eventually determined the debtors complied with the order. The state court entered judgment in favor of the creditor for the accrued penalty amount of $50 per day between the contempt finding in 2004 and the date of debtors' compliance in 2007 – totaling $63,950.00.

The creditor filed a proof of claim in the debtors' bankruptcy case. The claim included the remaining amount owed on the judgment, plus interest. The bankruptcy court allowed the claim over the debtors' objection and the debtors appealed. The debtors argued that the creditor could not claim any post-judgment interest.

The BAP disagreed with the debtors, holding that the creditor is entitled to interest from the date of judgment until commencement of the debtors' bankruptcy case. The BAP allowed the

interest because Missouri law permits it. Mo. Rev. Stat. § 408.040.1 ("[i]n all nontort actions, interest shall be allowed on all money due upon any judgment or order of any court from the date judgment is entered… until satisfaction."). The debtors argued that interest that accrued during the pendency of their state court appeal should not be allowed – but the BAP disagreed on this point too. Neither the statute nor associated case law provides for such an exception when the judgment debtor brings the appeal.

THE AUTOMATIC STAY APPLIES TO A NON-DEBTOR IMPROVEMENT DISTRICT ESTABLISHED BY THE GOVERNMENT BUT CONTROLLED BY THE DEBTOR

The case of *National Bank of Arkansas v. Panther Mountain Land Development, LLC* (*In re Panther Mountain Land Development, LLC*), No. 10-6086 (8th Cir. BAP, April 15, 2011) involves whether the stay applies to a non-debtor "improvement district," which is established by a government authority but essentially controlled by the debtor. The debtor in this case was a land developer and it petitioned and obtained approval to establish statutory improvement districts under Arkansas law for the developments owned by the debtor. The improvement districts established and held easements in the developments and obtained financing for sewers, roads and utility service to the undeveloped land. The improvement districts could impose assessments on the landowners to pay for such easements.

National Bank of Arkansas was the debtor's lender and had a mortgage on the developments at issue. National Bank, however, did not have any contractual relationship with the improvement districts, and it was concerned that the improvement districts' actions could create liens or encumbrances against the bank's collateral. National Bank argued in the bankruptcy case that the debtor had not given proper notice of the hearings which established the improvement districts, which violated, among other provisions, the Fourteenth Amendment. National Bank, therefore, wanted to commence a new state lawsuit against the improvement districts to challenge the constitutionality of their establishment. Although the improvement districts were not debtors in the bankruptcy, National Bank filed a motion for relief as a precaution before commencing the state court action. National Bank had already filed a number of motions for relief which were not successful because the court found the developments' value created an adequate equity cushion.

The debtor, meanwhile, filed a motion to sell a number of lots in the development and objected to the motion for relief in that it would interfere with the debtor's bankruptcy. The bankruptcy court in fact found that the automatic stay applied because the action against the improvement districts would in effect "exercise control over property of the estate," in violation of 11 U.S.C. § 362(a)(3). The BAP would not attack testimony relied on by the bankruptcy court that the buyer in the proposed sale deemed the easements held by the improvement districts to be critical to the development and would not buy any lots from the development without those easements in place and available to use. The bankruptcy court further found

cause was not present to lift the stay. Specifically, the improvement districts also now exercised an interest in the property of the estate, and could not take any significant actions with respect to that property without prior bankruptcy court approval. Thus, there was a forum where the secured lender's rights could be heard before the improvement districts undertook substantial improvements which could prejudice the lender's rights.

A STATE COURT ACTION REQUIRING A FINDING OF "RECKLESS" AND "DELIBERATE" MISCONDUCT DOES NOT COLLATERALLY ESTOP A PROCEEDING TO EXCEPT DEBT FROM DISCHARGE ON A "WILLFUL AND MALICIOUS INJURY" THEORY

In *In re Bullard*, 449 B.R. 379 (8th Cir. BAP, June 14, 2011), the creditor attempted to except from discharge the debtor's liability to creditor due to "willful and malicious injury" under 11 U.S.C. § 523(a)(6). The creditor and debtor got into an argument at a tiki bar. The debtor threw a bottle down on the table, shattering the bottle, and significantly injuring the creditor when a piece of glass went into the creditor's eye. The debtor was criminally charged and eventually plead guilty to second-degree battery. The creditor brought a civil case against the debtor in Arkansas state court. The debtor stipulated to liability and the issue of damages went to a jury. The jury awarded the creditor $204,204.11.

The creditor brought an adversary proceeding to exempt the debtor's liability in the civil case from discharge. The creditor argued that the bankruptcy court was collaterally estopped from making a determination on the willfulness and maliciousness of the debtor's actions because this had already been determined in the state court actions. The bankruptcy court held, and the BAP agreed, that the bankruptcy court was not estopped by the state court actions.

The court held that collateral estoppel may apply in a dischargeability action brought under § 523 of the bankruptcy code – but it did not apply here. First, the issues in the dischargeability action were not essential to judgment in the criminal action. The criminal battery statute requires a finding that debtor's actions were purposeful or reckless. Conversely, recklessness would not support an action under § 523(a)(6). Second, because the debtor stipulated to liability in the civil action, issues of willfulness and maliciousness were never "actually litigated" – which is a requirement of Arkansas' collateral estoppel doctrine – therefore, collateral estoppel could not apply.

A TRUSTEE CANNOT SELL JOINTLY-OWNED PROPERTY WHERE THE DETRIMENT TO THE NON-DEBTOR CO-OWNER OUTWEIGHS THE BENEFIT TO THE ESTATE

In *Lovald v. Tennyson* (*In re Wolk*), No. 11-6027 (8th Cir. BAP, July 14, 2011), the BAP upheld the bankruptcy court's ruling that a trustee had not met its burden under 11 U.S.C. § 363(h) to show that selling jointly-owned property provided sufficient benefits for the estate to outweigh the detriment to the non-debtor co-owner, and therefore the trustee could not sell the property under

Section 363(b). The property had equity of approximately $63,000, but there had been a dispute as to whether or not the trustee could claim half of the equity as a bona fide purchaser under 11 U.S.C. § 544(a) and South Dakota law, or the non-debtor co-owner could claim most of the equity because she had paid most of the down payment and all of the mortgage payments. The bankruptcy court simply assumed the trustee could claim half the equity, but found that $31,500 before liquidation costs was an insufficient benefit to the estate versus the hardship testified to by the co-owner. The BAP noted substantial evidence of detriment including a "history of depression" and testimony by the co-owner's therapist that the sale could cause the co-owner "significant health issues."

REPLEVIN IS NOT A CORE CIVIL PROCEEDING ARISING UNDER CHAPTER 11

In *Schmidt v. Klein Bank (In re Dale F. Schmidt and Terri E. Schmidt)* Adv. No. 11-6028, (*In re Douglas W. Schmidt and Kelly A. Schmidt*) Adv. No. 11-6029, and (*In re David L. Schmidt and Dawn M. Schmidt*) Adv. No. 11-6030 (8th Cir. BAP, August 3, 2011), the BAP reversed decisions of the bankruptcy court and held that matters involved in replevin actions were not core chapter 11 proceedings.

In February 2011, Klein Bank filed lawsuits against the Schmidts and several of their companies asserting replevin claims (among other related claims). Prior to the replevin hearings, the Schmidts all filed for bankruptcy protection under chapter 11 and then filed notices of removal to the bankruptcy court. The bankruptcy court determined that the replevin actions were core proceedings. In the appeals of those bankruptcy court orders, Klein Bank argued that the replevin actions did not "arise under" Title 11 because they did not involve causes of action expressly created or determined by the Bankruptcy Code, nor did the claims involve a right created by federal bankruptcy law.

While the appeals were pending, the United States Supreme Court in *Stern v. Marshall* provided clarification on the issue holding that "core proceedings are those that arise in a bankruptcy case or under title 11," regardless of whether the matter can be fitted into one of core proceedings enumerated in 28 U.S.C. § 157(b)(2). The BAP agreed with Klein Bank and reversed the decision of the bankruptcy court, holding in light of *Stern v. Marshall* that the replevin actions were not core proceedings because they "did not arise" in the Schmidts' bankruptcy cases.

A POSSIBLE PROPENSITY FOR FRAUDULENT BEHAVIOR DOES NOT MAKE UP FOR THE LACK OF EVIDENCE OF INTENT TO DEFRAUD, MALICE OR WILLFULNESS

The debtor in *Young v. Young (In re James Charles Young)*, Adv. No. 10-6008 (Bankr. D. Minn., Dec. 21, 2010) is the son of the plaintiff to whom he owes a personal debt based on accounts opened by the debtor in the plaintiff's name. Even though there was some testimony regarding his possible propensity for fraudulent and willful behavior, Judge O'Brien found there was not a preponderance of the evidence to prove the factors of 11 U.S.C. §§ 523(a)(2)(A) and (a)(6) and therefore the

debtor's debts to plaintiff are dischargeable.

The plaintiff filed this adversary case for a determination that his son's debts to him were nondischargeable under §§ 523(a)(2)(A) and (a)(6) because his son stole his identity and fraudulently obtained credit accounts and funds in his name. The trial consisted of testimony from both sides, including family members and significant others attempting to characterize the financial situation between father and son, which was all very personal and often times not credible. The court noted that the actual evidence regarding the allegedly fraudulent accounts opened by the debtor were incomplete and not helpful. What was most influential in the court's decision was the fact that the plaintiff admitted to opening at least two accounts in his name for his son, although the plaintiff insisted that he just wanted to help his son's credit position and did not open the accounts in order for his son to actually use the accounts.

Under § 523(a)(2)(A), a plaintiff must prove that a debtor made a knowingly false representation to deliberately deceive the creditor, on which the creditor justifiably relied on to sustain a loss. In this case, the court concluded that there was insufficient evidence that the plaintiff justifiably relied on the assertion that the debtor would not use the credit accounts set up in his father's name. The court noted that the plaintiff was educated, and that based on his knowledge and intelligence it was implausible that he genuinely believed that he could financially assist his son by simply lending his son his name without his son actually using the credit accounts. Further, the plaintiff willingly and knowingly allowed the debtor to set up accounts in his name, which does not support an assertion that a false representation was made by the debtor.

Under § 523(a)(6), a plaintiff must prove that the debtor acted with both malice and willfulness, as independent factors, or that the debtor acted intentionally, and not just recklessly, in a way that he is substantially certain will injure the plaintiff. Again, the court held that the plaintiff did not prove by a preponderance of the evidence that the debtor acted willfully or with malice, but instead "the facts merely indicate unreasonably optimistic exploitation of foolish generosity." Even if the debtor should have known that his father would be hurt by his excessive borrowing in his father's name, the debtor had permission to open the accounts. Moreover, there was evidence that the debtor was making efforts to mitigate and settle some of the debts in his father's name, which directly contradicts the allegation that he was intentionally harming his father.

Even though it was clear that the debtor's actions were injurious to his father's credit, and that the debtor's actions ultimately destroyed the relationship he had with his father and other family members, his actions did not meet the requirements of §§ 523(a)(2)(A) or (a)(6) and the debts to his father are dischargeable.

CHAPTER 7 DEBTORS REDUCE LIVING EXPENSES AND ARE FORCED TO CONVERT TO CHAPTER 13

In *In re Daniel James and Kristin Susann Corrigan*, No. 10-32168 (Bankr. D. Minn., Feb. 17, 2011) Judge O'Brien held that the debtors' chapter 7 bankruptcy case would be an abuse of the provisions of chapter 7 because the debtors substantially reduced their living expenses and therefore had the ability to pay and make a meaningful distribution in a chapter 13 case.

The debtors faced mounting medical and legal expenses, in addition to their high living, car and student loan debt, so filed a chapter 7 bankruptcy case. After filing, the first lien holder on their residence sought and received relief from the automatic stay and the debtors moved out of the house in fear that the creditor would pursue foreclosure. By moving out and renting a cheaper apartment, the debtors, a family of three, reduced their housing expenses by almost $3,000. In addition to the self-imposed reduction in housing expenses, the debtors' tax liability and car expenses were re-amortized to further reduce the debtors' monthly expenses.

Upon the US Trustee's motion, the bankruptcy court ordered that the debtors must convert their bankruptcy case to chapter 13 or their case would be dismissed. For this determination, the court analyzed the meaning of "totality of the circumstances" in 11 U.S.C. § 707(b)(3)(A), which governs if granting a debtor relief under chapter 7 would be an abuse of the provisions of a chapter 7 case. The court stated that the primary factor, if not the exclusive factor, when looking at the totality of a debtor's circumstances, is the debtor's ability to pay. Beyond the ability to pay, courts also consider factors such as eligibility for relief under another chapter, availability of non-bankruptcy remedies, likelihood of privately negotiated deals, a debtor's excessive budget, the presence of a stable source of future income, possibility of reducing expenses, and the prospect of a meaningful distribution in a chapter 13 case. In this case, the court found that not only did the debtors drastically reduce their expenses, but their original budget for housing costs was unreasonable, the debtors had a stable source of future income, possible non-bankruptcy remedies based on a family-owned business, and because of the reduced expenses, there would be a meaningful distribution in a chapter 13 case. The presence of the ability to pay, coupled with several other important factors, met the "totality of the circumstances" test of § 707(b)(3)(A), and the court found that granting the debtors' relief under chapter 7 would be an abuse, and the debtors must convert their case to chapter 13 or have their case dismissed.

THE TRANSFER OF EXEMPT PROPERTY CANNOT BE A CONSTRUCTIVE FRAUDULENT TRANSFER

In *Lumbar v. Welsh* (*In re Mary Joan Lumbar*), 446 B.R. 316 (Bankr. D. Minn., March 3, 2011) (Kishel, J.), the court examined whether the transfer of the debtor's exempt property was a fraudulent transfer under Minnesota law.

The debtor and her then-husband lived at a property that they were purchasing from the debtor's parents under a contract for deed. Upon the divorce of the debtor and her husband, the debtor

executed, among other things, a quitclaim deed to the debtor's parents. The quitclaim deed was not recorded or filed in the land records for the county.

The bankruptcy trustee brought an adversary proceeding against the parents of the bankruptcy debtor. The bankruptcy court held that the transfer to the parents could not be constructively fraudulent under Minn. Stat. §§ 513.44 and 513.45 since the property was the debtor's exempt homestead, and state law does not allow exempt property to be the subject of a fraudulent transfer avoidance action. In addition, the failure to record the quitclaim deed did not allow the trustee to avoid the transfer as a hypothetical bona fide purchaser under 11 U.S.C. § 544(a)(3). The exempt status of the property when the debtor conveyed it to her parents took the transfer out of the purview of the recording requirements. The state-law preclusion of a fraudulent transfer claim against a homestead also extended to the federal created remedy of § 548(a)(1), and, thus, the transfer was not constructively fraudulent under § 548. Finally, the court held that the trustee's allegations of the fraudulent motives of the parents did not establish fraudulent intent on the part of the debtor.

A CHAPTER 7 TRUSTEE NEED NOT PROVE THE VALUE OF ASSETS SIMPLY BECAUSE (S)HE OBJECTS TO A DEBTOR'S CLASSIFICATION OF SUCH ASSETS AS EXEMPT

In the case of *In re Wizcek*, 10-51280 (Bankr. D. Minn., June 16, 2011) (Kishel, J.), a chapter 7 trustee objected to the debtors' amended claims of exemption in multiple assets. The debtors held ownership interests in multiple business enterprises. In their initial schedules, the debtors represented that the businesses in which they held ownership interests were worthless and thus valued their exemptions in such ownership interests at "100%." The chapter 7 trustee objected on grounds that such exemptions should be expressly limited to amounts remaining available to the debtors (if any) under the "wild card" exemption provided by 11 U.S.C. § 522(d)(5), and the court entered an order to that effect.

Approximately three months after the court entered its order, the debtors amended their schedules. In their amendments, the debtors recharacterized their exemptions in the relevant business ownership interests as "100% of FMV," and reiterated their assertion that the businesses themselves had no value. The chapter 7 trustee objected to the debtors' amended characterization of their exemptions. In her second objection, the trustee argued that the maximum value of the debtors' exemptions had already been set by the court's earlier order, and the debtors should not be permitted any exemption that would exceed such limitations. In their response, the debtors argued that the trustee had "failed to demonstrate that the Debtors' amended exemptions exceed the limitations imposed in the court's [order]."

The court resolved this dispute in favor of the chapter 7 trustee. In its opinion, the court determined that the debtors' right to retain their business ownership interests are "statutorily delimited by value" pursuant to 11 U.S.C. § 522(d)(5). Accordingly, the court concluded that the extent of any protected interest in such property would be "measured by a dollar-value,

eventually to be reduced to a number," and the court found that the debtors had "no right to force the issue of control of the equity interests themselves, by raising a hypothetical issue of value." The court rejected the notion that a trustee must show that property has non-exempt value before (s)he can exercise control over it. Instead, the court reasoned, the bankruptcy estate retains title to the debtors' property regardless of outstanding valuation issues. Based on this rationale, the court concluded that a trustee should be permitted to exercise control over a debtor's property, without the need for prefatory litigation on valuation issues, until the value of such property can be determined through the normal, administrative course of bankruptcy proceedings (such as through a sale of assets or other means of liquidation).

IN THE WAKE OF *STERN V. MARSHALL*, BANKRUPTCY COURT REQUIRES EXPRESS CONSENT TO ENTER FINAL JUDGMENT ON ESTATE'S STATE LAW COUNTERCLAIM

In *Stoebner v. PNY Technologies (In re Polaroid Corp. et al.)*, No. 10-4595 (Bankr. D. Minn., July 7, 2011), the chapter 7 trustee instituted an adversary proceeding against the defendant seeking a money judgment of approximately $500,000, as well as disallowance of the defendant's claim in the underlying bankruptcy cases. In the adversary proceeding, the trustee asserted that the defendant was the recipient of a preferential transfer as well as breached a pre-petition contract with the debtor under a Brand Licensing Agreement. However, while the action was pending, the United States Supreme Court issued its decision in *Stern v. Marshall*, __ U.S. ___, 131 S.Ct. 2594 (2011) (Roberts, C.J.), implicating the bankruptcy court's authority to enter a final judgment on the trustee's state-law breach of contract counterclaim.

Pursuant to 28 U.S.C. § 157(c)(1) and (2), unless parties to the litigation consent to the entry of a final order, the bankruptcy court may not enter a final order in a non-core proceedings. Rather, the court may only hear the proceedings and submit findings of fact and conclusions of law to the district court for a final determination. As noted, the trustee's breach of contract counterclaim against the defendant fell directly within the scope of actions consequentially affected by the Supreme Court's ruling in *Stern*, and required a review of the record to determine if the parties to the current litigation consented to the entry of a final judgment by the bankruptcy court. Although the trustee's counterclaim fell within the definition of "core proceedings" found in 28 U.S.C. § 157(b)(2)(C), as a counterclaim by the estate against an individual filing a claim against the estate, the breach of contract action was a state common-law cause of action that existed independently of the federal Bankruptcy Code.

The record before the court was unclear as to whether the defendant affirmatively consented to the bankruptcy court's entry of a final order as to the common-law claim. Even in formally complying with the pleading requirements of Federal Rule of Bankruptcy Procedure 7008(a), by characterizing the breach of contract claim as "non-core" in the initial complaint, it failed to grant or withhold consent to the entry of a final order. Additionally, in cross-motions for summary judgment, the parties neither expressly withheld consent, nor

affirmatively acquiesced to the bankruptcy court's authority to finally dispose of the matter at bar, with the defendant incorrectly characterizing the issue as one of a lack of the bankruptcy court's jurisdiction over the matter. As this issue directly affected the Court's ability to formally dispose of the trustee's claim, the bankruptcy court directed the filing of express written statements by both parties as to whether they consented to the entry of final judgment by the bankruptcy court in the state law breach of contract claim.

EXEMPTION OF PROPERTY ALONE MAY NOT AVOID CREDITOR'S LIEN

In *In Re Wayne Gordon Reitberger and Linda Marie Reitberger*, No. 11-30633 (Bankr. D. Minn., August 27, 2011), the court held that exemption of property from a bankruptcy estate does not by itself avoid a lien on the exempted property.

Shortly after the debtors filed their chapter 13 petition, the IRS filed a proof of claim and asserted a secured claim against the debtors' estate. The IRS attached a facsimile federal tax lien document to its proof of claim, showing a notice of lien filed six years before the petition date. Debtors objected to the claim on several bases, and in particular, the debtors argued that the IRS could not have a secured claim against personal property exempt under the Bankruptcy Code and the Internal Revenue Code ("I.R.C.").

The court overruled the debtors' objection and allowed the secured claim of the IRS, holding that the Bankruptcy Code and the I.R.C. may protect certain property from levy by the IRS, but it does not eliminate its security interest in such property.

CHAPTER 7 DEBTORS DO NOT HAVE STANDING TO APPEAL THE DISMISSAL OF CLAIMS THAT BELONG TO THE ESTATE

In the case *Northern Nat'l Bank n/k/a Frandsen Bank & Trust v. Stephen J. Wiczek, et al.*, A10-1488 and A10-1678 (Minn. App., May 16, 2011) (P.J. Stauber, J. Kalitowski, and J. Worke), the Minnesota Court of Appeals determined, among other things, that two chapter 7 debtors did not have standing to appeal the dismissal of counterclaims belonging to their bankruptcy estate.

The bankruptcy debtors held ownership interests in multiple business enterprises. Prior to their bankruptcy filings, Northern National Bank (now known as Frandsen Bank & Trust) sued the debtors and one of their companies for foreclosure and to enforce the debtors' personal guaranties. The debtors answered Northern National Bank's complaint and also asserted counterclaims in the litigation. The district court granted summary judgment in favor of Northern National Bank and dismissed the debtors' counterclaims. After summary judgment was entered against them, the debtors filed for bankruptcy and filed an appeal challenging the district court's dismissal of their counterclaims against the bank.

In its decision, the Minnesota Court of Appeals first noted that, once the debtors filed for bankruptcy, all of their assets and interests became property of the bankruptcy estate. Accordingly, the Court of Appeals reasoned that the debtors' counterclaims belonged to the estate, and not to the debtors in their

individual capacities. The Court of Appeals then concluded that, because the debtors no longer held an interest in their counterclaims, they did not have standing to appeal the dismissal of such claims by the district court.