Bankruptcy Bulletin

A Publication of the Minnesota State Bar Association Bankruptcy Section

FALL 2012

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Discharge Denied Where the Debtor Undervalued Numerous Business Interests.

A debtor who undervalued multiple business interests and his personal residence in his schedules, as well as overvalued the encumbrance against the residence, made a false oath in his schedules and could not receive a discharge pursuant to Section 727(a)(4)(A) of the Code. *Kaler v. Charles (in re Charles)*, 12-6016 (8th Cir. BAP, July 16, 2012).

The debtor in *Charles* scheduled two business interests as worth $1.00. The debtor later amended his schedules and statement of financial affairs to show that he received dividends from one corporate interest in 2010 and substantial income from both entities. The debtor also amended Schedule D to reduce the amount of his mortgage balance against his residence.

The bankruptcy court denied the debtor's discharge and the bankruptcy appellate panel affirmed the ruling. Section 727(a)(4) requires denial of discharge where the debtor knowingly and fraudulently makes a false oath or account which is materially relevant to the bankruptcy case. Statements made with reckless indifference are regarded as intentionally false, and indifference may be found where there multiple false statements under oath. The materiality threshold for false statements is low.

The bankruptcy court denied the discharge after considering substantial evidence that the debtor undervalued his interests, including appraisals of his residence and one of his companies. The debtor had purchased one membership interest he valued at $1.00 for $25,000 approximately 20 months before the bankruptcy filing. He valued that same membership interest worth $63,000 on a financial statement only a few months after the purchase, and the company had an appraised value at the time of over $600,000. The debtor knew these facts when he filed.

He had also valued his residence in the same amount as an offer he previously received and rejected because he believed it too low. The record before the bankruptcy court adequately demonstrated at least he acted with reckless indifference, and the valuation dispute was not simply a good faith difference of opinion. Nor did the valuation of $1.00 trigger a duty for the trustee to investigate which defeated the debtor's obligation for full and complete disclosure.

The BAP therefore did not find clear error in the bankruptcy court's assessment of the record.

Minnesota Court of Appeals Finds that When Marital Property is Impermissibly Liquidated, it Becomes Attachable by the Liquidating Party's Creditors.

In a non-bankruptcy case, *CorePoint Capital Finance, LLC v. Hecker*, 2012 WL 360413 (Minn. Ct. App. Feb. 6, 2012), the Minnesota Court of Appeals decided the extent to which an entity may garnish a debtor's funds held by the district court.

In April 2008, the appellant initiated marriage dissolution proceedings against her husband, during which the latter disclosed two retirement accounts held in his name. As the accounts were

marital property, both parties were temporarily restrained from disposing of their contents due to the dissolution proceedings. Despite this prohibition, the appellant's husband liquidated and disposed of the contents of one account, which held $125,155.74. The family court subsequently held the husband to be in contempt and ordered that he restore the liquidated amount to the account. Unable to personally restore the account, the husband obtained the necessary funds from an acquaintance. However, as the account was closed upon liquidation, the family court ordered the husband to deposit the amount with the Hennepin County district court, after which a stipulation was entered awarding the appellant the funds in question.

Prior to the stipulation, and unbeknownst to the appellant, Chrysler Financial Services Americas, LLC served the district court with a garnishment summons for the funds held by the district court. Upon learning of the garnishment summons, the appellant petitioned the family court, which in turn referred the matter to the district court.

The appellant primarily argued that the funds were marital property and beyond the reach of creditors, to which the district court held that the funds were a gift from the husband's acquaintance and received after dissolution. Therefore, they were properly attachable non-marital property. The appellant alternatively argued that the funds were held *in custodia legis*, and were not subject to garnishment. In response, the district court held that the funds were transferred to the district court in order to purge the husband's contempt charge rather than for protection against creditors. This appeal followed.

The court of appeals agreed with the district court that the funds were transferred as a means of purging the contempt charge rather than to protect them from the reach of creditors. Further, the court compared the power of a court-appointed receiver to that of the district court administrator, finding that the latter did not exercise sufficient control or dominion over the funds needed to find them *in custodia legis*. While a receiver must make substantive business decisions involving the liquidation, disposal, or investment of property, the administrator was merely tasked with holding the funds and distributing them as directed by the court.

The appellant then argued that the husband never had possession of funds, which therefore exempted them from garnishment. The court quickly dispensed with this argument, holding that the husband had constructive possession while the district court administrator merely had custody. The gift to the husband became his unencumbered property, which he then transferred to the district court administrator. When a property owner intentionally transfers physical control of property to another for the purposes of performing some act for the owner, the owner maintains constructive possession. In the current instance, the property owner intentionally transferred property for the purpose of purging the contempt charge levied by the family court.

Student Loans Not Discharged for Service Technician with Regular Income, No Extraordinary Living

Expenses and Who Qualified for $0.00 ICRP Payments.

A debtor could not show undue hardship to discharge student loans where he had a steady source of income, could not demonstrate substantial and necessary expenses, and did not take advantage of a $0.00 monthly payment through the Income Contingent Repayment Program. *Nielsen v. ACS, Inc. (In re Nielsen)*, 12 - 6020 (8th Cir. BAP, June 21, 2012). The debtor appealed the bankruptcy court's determination denying his request to discharge student loan debt. The court did not find undue hardship which is based on a fact and circumstances test focusing on the availability of reliable financial resources, reasonable and necessary living expenses, and other extraordinary facts.

The debtor was a service technician who in addition to his annual $30,000 technician income, also received monthly food program assistance for his family, a $50 per month cell phone allowance, and a annual tax refund of approximately $8,000 per year. He held employment in his chosen field and had the ability to advance in the future. He also received health insurance coverage from his employer and periodic bonuses.

The debtor provided little detail with respect to his expenses but suggested that his family would have extraordinary expenses in the future related to possible mold exposure. He did not provide such evidence to establish this claim, and did not offer a formal mold sensitivity diagnosis.

The debtor further qualified for the ICRP and at his initial income level would not be required to make payments under that plan. While the court cannot determine dischargeability based on whether the debtor takes advantage of its ICRP eligibility, its failure to do so can be a consideration. The debtor claimed that he did not participate in ICRP because of the potential tax consequences at the end of the program related to debt forgiveness income, but courts have held this is not a valid excuse for failing to participate in the program.

Thus, the B.A.P. did not find an abuse of discretion in the bankruptcy court's determination of fact, and the debtor failed to meet the rigorous burden of showing undue hardship.

Bankruptcy Code does not Abrogate Sovereign Immunity of Federally-Recognized Tribes.

In *In re: Linda Rose Whitaker*, No. 12-6004, the B.A.P. was presented with four appeals arising out of adversary proceedings filed by Chapter 7 bankruptcy trustees against defendant-entities who were all federally recognized Indian tribes or subsidiaries thereof. The B.A.P. affirmed the bankruptcy court's underlying decisions which dismissed all of the adversary proceedings and held that all such defendants are protected from avoidance actions by sovereign immunity, absent their own bankruptcy filing.

In its reasoning, the B.A.P. noted that to abrogate sovereign immunity, congressional intent to do so must be unequivocally expressed in legislation. Generally, if the language of a federal statute does not include "Indian tribes" in the definition of parties that are subject to suit or does not otherwise specifically assert jurisdiction over "Indian tribes," the statute does not

qualify as an "unequivocal expression" of Congressional intent to abrogate sovereign immunity. In bankruptcy cases, Congress's only abrogation of sovereign immunity is found in Section 106(a) of the Bankruptcy Code, which provides that sovereign immunity is abrogated as to "governmental unit[s]." A "governmental unit" is defined in Section 101(27) of the Bankruptcy Code and means "United States; State; Commonwealth; District; Territory; … or other foreign or domestic government." Section 101(27), however, does not specifically mention Indian tribes.

Although the Supreme Court has referred to Indian tribes as "sovereigns," "nations," and even "independent political communities," the panel noted that the Supreme Court has never referred to an Indian tribe as a "government." Accordingly, the panel found that an Indian tribe is not a "foreign or domestic government" under Section 101(27) and Congress did not unequivocally express its intent to abrogate sovereign immunity of Indian tribes. The panel also found that tribal sovereign immunity extends to all of the subdivisions and agencies of a tribe and, therefore, financial subsidiary of an Indian tribe is also protected from suits under the Bankruptcy Code.

Debtor Who Created Pseudo-Governmental Entities to hold Its Property not Entitled to Protection of the Automatic Stay.

In *National Bank of Arkansas v. Panther Mountain Land Development, LLC*, No. 11-1900, the debtor formed pseudo-governmental entities under Arkansas law, so-called "Improvement Districts," to hold certain parcels of undeveloped land owned by the debtor. Under Arkansas law, the Improvement Districts had the capacity to sue and be sued, to enter into contracts, incur debts, etc.
After the debtor filed for bankruptcy, a secured creditor filed a motion seeking a ruling that a state law action against the Improvement Districts was not barred by the automatic stay. The same issue was presented to the Eighth Circuit on appeal and it reversed two underlying decisions, holding that the automatic stay did not apply to actions against the Improvement Districts.

While the stay bars actions against the debtor and actions "to obtain possession of property of the estate," it does not, in general, apply to actions against third parties. In reaching its decision, the Eighth Circuit found that the Improvement Districts were indeed separate legal entities and a suit against them was not the equivalent of an action against the debtor and therefore, not barred by the automatic stay. Moreover, the Eight Circuit found that the proposed action would not constitute an action to gain possession of, or exercise control over, estate property, even if the proposed state court action against the Improvement Districts could potentially affect the value of the debtor's estate.

Statutory Damages and Attorney's Fees Assessed by State Court in Fraud Action Must be Re-Proven in Bankruptcy Court to be Non-Dischargeable Even When the Bankruptcy Court Finds the Underlying Debt is Non-Dischargeable Due to Fraud.

In *Koller v. Hoffman (In re Hoffman)*, ____ B.R. ____ (Bankr. D. Minn. 2012),

the debtor had been a defendant in a state court real estate fraud case involving the purchase of the plaintiff's home. This purchase included financing by the seller-plaintiff to the debtor in the form of a promissory note. The debtor set up the transaction so the note appeared to be secured by the home but, in actuality, it was not. The state court entered judgment for actual damages, statutory damages, and attorney fees on the plaintiff's fraud claim and related state law claims. After the debtor filed Chapter 7 bankruptcy the plaintiff commenced an adversary proceeding against the debtor for non-dischargeabilty of the damages under 11 U.S.C. 523(a)(2)(A) which prevents discharge for debts incurred by fraud.

At trial, the bankruptcy court found the debtor committed actual fraud - largely relying on the disparity in knowledge between the parties. The debtor had significant real estate experience whereas the plaintiff had none. The court held that, although a close reading - by a lawyer - of all the documents provided by the debtor in the real estate transaction would have revealed the falsity of his representations, the plaintiff was a layperson inexperienced in these transactions and therefore justifiably relied on the debtor's representations.

The bankruptcy court ordered that the actual damages incurred by the plaintiff were non-dischargeable; that is, the money owed on the promissory note plus contractual interest. But the court did not except from discharge the statutory damages and attorney fees awarded by the state court. Because these additional damages arise from state statute, the state law claims must be re-litigated in the bankruptcy court for the resulting damages to be non-dischargeable.

Debtor is not Required to Turnover Property to the Bankruptcy Estate Under 11 U.S.C. § 542(a) Based on Trustee's Unjust Enrichment Theory.

In *Lovald v. Falzerano, (In re Falzerano)*, 686 F.3d 885 (8th Cir. 2012) a South Dakota debtor was deeded a life estate in certain ranch land. As part of a settlement from a will dispute, the debtor was permitted to manage a herd of cattle that were property of the probate estate and use profits from the land and cattle for the debtor's living expenses. Prior to filing Chapter 7 bankruptcy, the Debtor was sued in state court for $10,000 owed on a purchase of hay. The state court entered judgment against the debtor.

The Chapter 7 trustee filed a complaint under 11 U.S.C. § 542(a) against the debtor, the probate estate, and the debtor's fellow heirs. The trustee sued to recover rent for the pasture and the value of the hay provided to the probate estate's cattle. The trustee argued that the defendants were liable to the bankruptcy estate under an unjust enrichment theory.

The bankruptcy court entered judgment in favor of the Defendants and the BAP affirmed. The trustee appealed to the 8th Circuit, and the 8th Circuit affirmed.

The 8th Circuit held that the trustee's claim for unjust enrichment based upon a debt owed was beyond the scope 542(a). Section 542(a) is one of several provisions that bring into the estate property that was not in the debtor's possession when the case commenced. This section permits a trustee to compel turnover only from entities which have

control of property of the estate or its proceeds at the time of the turnover demand. Although 8th Circuit authority allows a 542(a) turnover action when a debtor retains an equitable interest in property of the estate, this, contrary to the trustee's assertion, does not translate to allowing turnover based on a theory of unjust enrichment.

Debt is Nondischargeable Pursuant to § 523(a)(4) due to Defalcation While Acting in a Fiduciary Capacity.

In the Chapter 7 case of *Granite Re, Inc. v. Pearson (In re Pearson)*, Adv. Pro. No. 11-3358 (Bankr. D. Minn. June 12, 2012), the court granted the plaintiff's motion for partial summary judgment, which sought an order that a portion of the defendant's debt to the plaintiff was nondischargeable pursuant to 11 U.S.C. § 523(a)(4).

Prior to his bankruptcy filing, the defendant executed an indemnity agreement in favor of the plaintiff in connection with the plaintiff's issuance of performance bonds covering construction projects undertaken by the defendant's company. The indemnity agreement specifically provided that all payments received by the defendant for which liability existed under the bonds were to be held in trust for the payment of the subcontractors and suppliers. The defendant, however, diverted $365,227.97 of the amount that should have been held in trust, and used it to pay expenses and costs not covered by the bonds. In pursuing its remedies, the plaintiff incurred $34,903.59 in attorney fees and costs.

The court agreed with the plaintiff that the $400,131.56 (the diverted funds plus attorney's fees and costs) owed by the defendant to the plaintiff should be adjudged non-dischargeable pursuant to section 523(a)(4). Section 523(a)(4) excepts from the discharge any debt for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny. The court described that defalcation is the failure to properly account for trust funds held in a fiduciary capacity, and specified that, for purposes of section 523(a)(4), defalcation includes innocent default of a fiduciary without intent to embezzle or defraud. Thus, the court held that the defendant's failure to use funds in accordance with the provisions of the indemnity agreement constituted defalcation, regardless of the reasons for the diversion.

Debt not Nondischargeable Pursuant to § 523(a)(4) where no Fiduciary Relationship Existed, Larceny was not Alleged, and there was no Embezzlement.

In the Chapter 13 case of *Arvest Mortgage Co. v. Nail (In re Nail)*, Case No. 11-2018 (8th Cir. June 5, 2012), the Eighth Circuit affirmed the BAP's judgment that a debt was not nondischargeable pursuant to 11 U.S.C. § 523(a)(4).

The debtor/appellee received a loan from the appellant, and granted appellant a mortgage on a newly-constructed home. The appellee discovered significant structural defects in the home, and sued the builders. The builders paid $65,000 to the appellee to settle the lawsuit. The mortgage assigned to appellant all "Miscellaneous Proceeds," which was defined to include "any . . . settlement . . . paid by any third party . . . for damage to, or destruction of, the

property." The appellee spent the settlement proceeds rather than remitting them to the appellant.

At issue in the Eighth Circuit was whether the $65,000 was nondischargeable under section 523(a)(4). The appellant argued that the debt was nondischargeable because the appellee committed fraud or defalcation while acting in a fiduciary capacity, or, in the alternative, embezzled the $65,000.

The court held that the debt was not nondischargeable pursuant to section 523(a)(4), noting that it construed the alleged bases for nondischargeability narrowly. With respect to the allegation of fraud or defalcation while acting in a fiduciary capacity, the court held that neither the mortgage document nor an Arkansas state statute created a fiduciary relationship and, as a result, the fiduciary capacity subpart of section 523(a)(4) did not apply.

With respect to embezzlement, the court noted that embezzlement required the fraudulent appropriation of property of another. The court found that the assignment provision in the mortgage merely granted the appellant a security interest in any Miscellaneous Proceeds. Thus, even assuming that the settlement proceeds were Miscellaneous Proceeds, the appellee owned the funds; although she may have been contractually obligated to remit the funds to the appellant, she could not embezzle them because she owned them. As the court stated, the appellee's "alleged failure to comply with the assignment provision was a dischargeable breach of contract, not a nondischargeable embezzlement."

Bankruptcy Trustee's Sale of Claims is Deemed Valid under Iowa Law Because Debtor was the Sole Heir of Decedent's Estate and Decedent had no Creditors.

In *McCleary v. Reliastar Life Insurance Company*, 11-3169 (8th Cir. June 29, 2012) (J. Wollman, J. Colloton and J. Hickey), Jaysen McCleary asserted claims as the administrator of his mother's estate against ReliaStar Life Insurance Company seeking to recover unpaid benefits. In addition to being the administrator of his mother's estate, Mr. McCleary was also his mother's sole heir, and he had filed for personal bankruptcy under Chapter 7 of the Bankruptcy Code before filing the lawsuit against ReliaStar.

Shortly after Mr. McCleary filed the lawsuit, ReliaStar negotiated an agreement with the trustee of Mr. McCleary's bankruptcy estate for the purchase of all claims against itself. The bankruptcy court approved the proposed sale and ReliaStar then moved for summary judgment in the lawsuit initiated by Mr. McCleary in district court, arguing that it (ReliaStar) now owned all of the claims being pursued by Mr. McCleary. The district court granted ReliaStar's motion.

On appeal, the U.S. Court of Appeals for the Eighth Circuit affirmed the district court's decision by reference to controlling state law. Specifically, the court of appeals noted that, under a decision by the Iowa Supreme Court, beneficiaries of an estate are allowed to settle claims of the estate in the absence of creditors. Accordingly, because Mr. McCleary was the sole beneficiary of his mother's estate, and his mother's estate

had no outstanding creditors at the time the claims at issue were sold to ReliaStar, Mr. Cleary was authorized to sell the claims at the time they were sold and the sale of such claims by the trustee of his bankruptcy estate was therefore valid under Iowa law.

BAP Sustains Trustee's Objection to Debtor's Claimed Homestead Exemption.

In *Andrew William Shirley v. Charles L. Smith* (*In re: Andrew William Shirley*), No. 12-6012 (8th Cir. BAP, June 15, 2012), the debtor and his spouse purchased a home on Southwest 16th Street in Des Moines, Iowa in 1995. The debtor lived there with his spouse and children until October 2007.

In June 2005, the bank commenced foreclosure proceedings against the debtor's mother's house on Kendallwood Circle in Des Moines, where his mother had lived since 1974. The Kendallwood Circle house was two-and-a-half miles from the Southwest 16th Street house. In November 2005, the debtor purchased his mother's house from the bank, using funds his mother gave him from a trust created upon his father's death.

The debtor's spouse commenced divorce proceedings in June 2007 and four months later, in compliance with the divorce court's order directing him to vacate the Southwest 16th Street house, the debtor moved into the house on Kendallwood Circle and resided there with his mother.

In late 2008 and again in early 2009, as a creditor was attempting to enforce a judgment against him, the debtor formally declared the Kendallwood Circle house his homestead. No consent was obtained from the debtor's spouse to change the family homestead.

The debtor's divorce was finalized in April 2009. In compliance with the decree of dissolution, the debtor quitclaimed his interest in the Southwest 16th Street house to his former spouse and the former spouse quitclaimed any interest she had in the Kendallwood Circle house – which was titled only in the debtor's name – to the debtor.

In May 2009, the debtor filed a petition for relief under chapter 7 of the bankruptcy code and claimed the Kendallwood Circle house exempt as his homestead under the Iowa Code. The trustee objected, arguing the debtor had not acquired the Kendallwood Circle house with proceeds from a previous homestead. The debtor opposed the trustee's objection, asserting that under the Iowa Code, he had the right to change the limits of the homestead and, alternatively, that he obtained the new homestead with proceeds from an old homestead.

The bankruptcy court rejected both of the debtor's arguments and ruled in favor of the trustee. The debtor timely appealed to the BAP.

The BAP affirmed, holding that the debtor's move from the Southwest 16th Street house to the Kendallwood Circle house did not constitute a change in the limits – i.e., the boundaries, of his homestead – but rather was a claim to an entirely different homestead. The BAP also reasoned that the debtor's family continued to occupy the original homestead on Southwest 16th Street after the debtor moved.

Additionally, the BAP held that the debtor acquired the Kendallwood Circle house from funds his mother gave him from a trust created upon his father's death, not from the sale of the Southwest 16th Street house or an exchange involving that house.

Accordingly, the BAP concluded that the Kendallwood Circle house was not the debtor's homestead and could be sold to satisfy his debts.

Eighth Circuit Holds Fraud and Securities Violations Claims are Not Dischargeable.

In *Nathan Paul Reuter v. Tana S. Cutcliff, et al.* (*In re: Nathan Paul Reuter*), No. 11-1339 (8th Cir., July 17, 2012), the debtor was a successful real estate developer and mortgage financier who in 2003 formed a business with Daryl Brown to sell securities and pursue real estate development opportunities.

By early 2004, however, the debtor had lost considerable funds in business dealings with Brown, had to assist Brown obtain a mortgage due to his poor credit, and had to pay a fine and admit that the company made misrepresentations as a result of Brown's actions.

In late 2004, Brown, through the business, concocted a "high-yield, zero-risk" investment opportunity scheme. The debtor solicited, among others, nine investors who were promised high commissions and interest along with the return of their original investment. In reality, Brown controlled the money and appropriated the funds. Each investor lost between $50,000 and $300,000.

In 2005, the State of Missouri initiated a civil suit against the business and others (including the debtor) for the sale of unregistered securities and misrepresentations about the instruments offered and sold. That proceeding primarily addressed conduct with investors other than the nine investors solicited by the debtor, who, in 2006, filed their own lawsuit against the business and the debtor in federal court.

Thereafter, the debtor filed for bankruptcy under chapter 11, listing the nine creditors' claims as contingent, unliquidated, and disputed. He proposed a chapter 11 plan to resolve the claims, but the nine creditors objected and filed an adversary proceeding, incorporating their original complaint and asserting their claims were non-dischargeable.

The bankruptcy court held the claims were non-dischargeable pursuant to 11 U.S.C. § 523(a) on each of three grounds: (1) all nine creditors were defrauded by Brown and the debtor was vicariously liable as Brown's partner, (2) five of the nine creditors were defrauded directly by the debtor, and (3) the debtor sold unregistered securities to five of the nine creditors and, thus, those claims, as well as incurred attorneys' fees, were non-dischargeable under § 523(a)(19).

The debtor appealed to the BAP, which affirmed in all respects. The debtor then appealed to the Eighth Circuit, arguing he was not vicariously liable for Brown's fraud, did not personally defraud five of the creditors, and did not personally "sell" the unregistered securities.

The Eighth Circuit affirmed, rejecting the debtor's argument that the bankruptcy court erred by granting non-

dischargeability of the nine creditors' claims without considering whether he actually owed a debt to the creditors under any state tort theory. The Eighth Circuit held that the record as a whole confirmed that the bankruptcy court was aware of the creditors' burden to prove the debtor's underlying liability on their claims.

The Eighth Circuit further held that substantial evidence established that the debtor considered Brown his partner, that the fraud was perpetrated in the ordinary course of the business's affairs, and that the record was replete with examples of red flags that should have alerted the debtor to the obvious conclusion that Brown was perpetrating a fraudulent scheme. As it affirmed the ruling on the nine creditors' vicarious liability claim, the Eighth Circuit did not reach whether the debtor had directly defrauded five of them.

Finally, the Eighth Circuit affirmed the bankruptcy court's ruling that the debtor violated state securities laws, reasoning that the evidence presented established that the debtor actually sold securities to five of the creditors. Accordingly, the Eighth Circuit found no error in the determination that their claim, and associated attorneys' fees incurred, were not dischargeable.

The Bankruptcy Appellate Panel Interprets the Elements Required for Nondischargeability Strictly.

In *Montgomery Bank, N.A., v. Steger*, 12-6018 (8th Cir. B.A.P. June 14, 2012) (C.J. Federman, J. Kressel and J. Nail), Montgomery Bank extended a construction loan to a limited liability company co-owned by the debtor and her business partner. The debtor and her partner were supposed to build a duplex at a designated location with the loan funds advanced to their company. Instead, the debtor and her partner used the bank's loan to construct a different duplex on a different lot. After a failed attempt to restructure and repay the bank's loan, the debtor filed for bankruptcy protection.

The bank filed an adversary proceeding against the debtor seeking an order of nondischargeability under multiple subsections of 11 U.S.C. § 523. The Bank alleged, among other things, that the debtor made false and fraudulent representations in her attempt to obtain the loan at issue, and that the debtor somehow committed an intentional tort through actions taken in connection with the loan. The case went to trial and the bankruptcy court ruled against the bank on all counts. Specifically, the bankruptcy court found no evidence that the debtor made a false statement *prior to* the bank's funding the loan as required by 11 U.S.C. § 523(a)(2)(A), and the bankruptcy court found no evidence of a tort, let alone an intentional one, as required by 11 U.S.C. § 523(a)(6).

On appeal, the Eighth Circuit's Bankruptcy Appellate Panel applied a "clear error" standard of review. The panel reviewed the bankruptcy court's material findings of fact, determined that each was supported by the record, and affirmed the bankruptcy court's decision in all respects.

Be Careful What You Sign and File With the Court.

In *Nett v. Manty* (In re Yehud-Monosson USA, Inc.), Civ No. 12-448, the US

District Court for the District of Minnesota upheld the bankruptcy court's order for sanctions based on a violation of Rule 9011 of the Federal Rules of Bankruptcy Procedure. Although the facts in this case chronicle a string of outrageous and scandalous facts, it also contains a warning for all attorneys.

The controversy in this adversary proceeding stem from a memorandum of law submitted to the bankruptcy court by the debtor's attorney that contained numerous personal attacks and allegations of bigotry, deceit, and conspiracy against bankruptcy judges, the trustee, US Trustee, and the bankruptcy court in general. The debtor's attorney told the bankruptcy court that the debtor had actually written the memorandum and she had simply signed it and submitted it to court.

Based on the statements made in the memorandum of law, the bankruptcy court, *sua sponte*, issued Orders to Show Cause to both the debtor and the debtor's attorney requiring both to appear to show cause why sanctions should not be imposed against them pursuant to Rule 9011. The debtor's attorney responded by stating that the debtor "absolutely" knew as fact that the decisions against it were unjust and based on prejudice due to an "infiltration of our justice system" by "the Roman cult and their military arm – the Jesuit Order." The bankruptcy court found that the memorandum contained "unsubstantiated, univestigated, and unfounded" statements alleged to be "facts", and that the debtor's attorney violated FRCP 9011(b)(1) and (3). Based on this violation, the bankruptcy court ordered the debtor's attorney to pay a $5,000 fine, enjoined her from filing future documents referring to the religious beliefs of the court and parties, and required her to attend ten hours of legal ethics training. The attorney appealed the order for sanctions.

The US District Court held that although the law is unclear that an order for Rule 11 sanctions is a final and appealable order, it used its discretion and granted leave for an interlocutory appeal. On the merits of the appeal, the district court first held that the bankruptcy judge did not need to recuse herself from the hearing to determine Rule 9011 sanctions. The issue was not timely brought, and the debtor's attorney failed to show that the bankruptcy judge was biased or that the debtor or its attorney was prejudiced by any alleged bias. Judges are allowed to form opinions based on facts introduced in court or events occurring during court proceedings, and these opinions do not constitute a bias unless such opinions display a "deep-seeded favoritism or antagonism" that would make justice impossible.

Next, the district court held that the bankruptcy court did not error by finding a violation of Rule 9011. Rule 9011 requires that attorneys sign all motions and pleadings, and that such signature is a certification that the signed document contain statements that, to the best of the attorney's knowledge, information and belief, were "formed after an inquiry reasonable under the circumstances" and have evidentiary support, and that the document is not filed for "any improper purpose, such as to harass." Fed. R. Bankr. P. 9011(b)(1) and (3). The debtor's attorney admitted to the bankruptcy court that she did not write the memorandum but simply signed what the debtor had written. Additionally, the pleading was submitted

for the improper purpose to harass. These factors show a clear violation of Rule 9011.

Finally, the district court analyzed the actual sanction imposed against the debtor's attorney. Although the debtor's attorney promised that her actions were an isolated event that would not be repeated, one purpose for imposing Rule 9011 sanctions is to deter others in similarly situations from repeating such behavior. Additionally, the sanctions were imposed for the attorney's "complete shirking of her responsibilities under Rule 9011." An attorney must review and investigate the factual basis of the statements made in pleadings submitted to the court bearing the attorney's signature. Therefore, ordering sanctions was appropriate.

Since this decision, the Office of Lawyers Professional Responsibility has filed a petition for discipline against the debtor's attorney based on her "pattern of bad faith litigations and reckless and harassing statements."

A Debtor Cannot Exempt Under Section 522(d)(1) Pre-Petition Insurance Proceeds Received Following Damage to His Home

In re Lauwagie, Bankr. Case No. 11-37707 (Bankr. D. Minn. May 15, 2012) (Judge O'Brien).

The Chapter 7 trustee objected to the debtor's claimed exemption in the proceeds of insurance payments following pre-petition hail damage to the roof of the debtor's home. Following the hail storm, the debtor's roof was repaired and the debtor's mortgagee received a check in the amount of $6,167.48 payable to the debtor and the mortgagee. The mortgagee maintained possession of the check on the petition date. The debtor claimed an exemption of the insurance proceeds under 11 U.S.C. Sec. 522(d)(1), asserting that the insurance proceeds are part of the aggregate value of his interest in his home subject to exemption. The trustee objected. Pursuant to 11 U.S.C. Sec. 522(d)(1), "[t]he following property may be exempted under section (b)(2) of this section: [t]he debtor's aggregate interest, not to exceed $15,000 in value, in real property or personal property that the debtor … uses as a residence…." The Court sustained the trustee's objection to the exemption holding that the insurance proceeds received pre-petition are not part of the aggregate value of the residence, and as such, cannot be claimed exempt under 11 U.S.C. Sec. 522(d)(1).

The Debtor Obtained an Order for Dismissal over the Objection of a Creditor

Engen v. Sowada (In re Sowada), Civ. No. 12-497-PAM (D. Minn. July 16, 2012).

Creditors appealed an order of the bankruptcy court (Kressel, J.) granting the debtor's motion to dismiss his chapter 11 bankruptcy case. The debtor was a real estate developer who had conducted business with the objecting creditors over the years. The debtor filed a chapter 11 petition after an investor won a large judgment against him and his non-debtor spouse. The debtor then negotiated a settlement with the investor, ignored the bankruptcy court's deadline to file a plan and disclosure statement, and instead filed a motion to dismiss his case. Creditors

objected to the debtor's motion to dismiss, arguing that they would be prejudiced by dismissal and alleging that the debtor had fraudulently obtained the confidential settlement. The district court found that the bankruptcy court did not abuse its discretion in granting the debtor's motion to dismiss and agreed that dismissal was in the best interests of the estate and creditors, five of whom had supported dismissal. The district court also agreed with the bankruptcy court that although the secrecy of the settlement was concerning, dismissal was warranted because there was no prejudice to the creditors, who could continue to pursue their claims against the debtor in state court.

The U.S. Supreme Court interprets the Cramdown Provisions of 1129(b)(2)(A)

In a case focused more on statutory interpretation than substantive bankruptcy law, the United States Supreme Court, in RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 132 S.Ct. 2065 (2011), held that a debtor attempting to cramdown a chapter 11 plan of reorganization must allow a secured creditor to credit bid if the debtor wishes to sell the creditor's collateral free and clear.

In 2007, the Petitioner purchased a hotel at Los Angeles International Airport, as well as an adjacent lot, the latter of which was to be turned into a parking structure. To finance the acquisition, the Petitioner incurred $142 million in bank debt from a bank of which Respondent served as trustee. Unable complete the renovation of the parking structure, and owing more than $120 million on the loan, with over $1 million in interest accruing each month, the Petitioner filed for Chapter 11 protection in the Bankruptcy Court for the Northern District of Illinois. The Petitioner's subsequent Chapter 11 plan proposed an auction of the Petitioner's assets to the highest bidder. However, under the plan, the Respondent would not be allowed to credit-bid for the collateral securing its loan. Anticipating the Respondent's objection, the Petitioner attempted to cramdown the plan under 11 U.S.C. § 1129(b)(2)(A). The Bankruptcy Court denied confirmation, holding that the plan did not comply with 11 U.S.C. §1129(b)(2)(A)'s cramdown requirements. Appeal directly to the Seventh Circuit Court of Appeals followed, which affirmed the Bankruptcy Court's decision, leading to the current appeal.

From the outset, the Court stated that two particular provisions were at issue. The first being 11 U.S.C. § 1129(b)(2)(A)(ii) ("Clause ii"), which allows the cramdown of a Chapter 11 plan through the sale of the debtor's assets free and clear, provided that secured creditor may credit-bid on its collateral. The second being 11 U.S.C. § 1129(b)(2)(A)(iii) ("Clause iii"), which allows cramdown provided the secured creditor receive the "indubitable equivalent" of its claim. The Petitioners were attempting to cramdown its plan by use of the latter provision, which is silent with regard to asset sale and credit-bidding. In its defense the Petitioner stated that it would be satisfying Clause iii, as the Respondent would be receiving the indubitable equivalent in the form of cash payments from the auction.

The Court utilized the canon of statutory construction that the "specific governs

the general." In essence, the canon mandates that the specific language in a statute will prevail over general language located elsewhere within the same statute. Though most often utilized in circumstances where a general permission or prohibition is contradicted by more specific language, the canon has equal force when a general authorization coexists side-by-side with a more limited and specific authorization. In such instances, the terms of the specific authorization must be met. In the current instance, Clause ii specifically details the requirements for selling collateral free and clear, and explicitly requires that the secured creditor be allowed to credit bid. However, Clause iii is broadly worded and mentions nothing with regard to such a sale. Therefore, as the specific governs the general, the explicit requirements of Clause ii, to include credit-bidding, must be met when a debtor attempts to cramdown a Chapter 11 plan through the sale of its assets free and clear.

The Eight Circuit Analyzes Katchen, Granfinanciera and Langenkamp in the Wake of Stern

In the case of Pearson Education, Inc. v. Almgren, 11-2723 (8th Cir. July 13, 2012) (J. Gruender), the Eighth Circuit Court of Appeals differentiated the impact of several landmark United States Supreme Court cases with regard to the right to jury trial, as well as analyzed the intersection of federal copyright and bankruptcy laws.

The Appellee, a graduate student at Augsburg College, obtained unlicensed instructor's solution manuals for his classes. Seeing the entrepreneurial value in obtaining such manuals, the Appellee obtained copies of other solution manuals from the Appellants under false pretenses. After the publishers acquiesced to the Appellee's requests, the Appellee sold the manuals through the same website from which he purchased the original manual, realizing approximately $5,000 in profits. The Appellants quickly learned of the Appellee's scheme and filed a copyright infringement suit against the Appellee in the District Court for the Southern District of New York. The economic toll caused by the litigation lead the Appellee to file for chapter 7 protection in the Bankruptcy Court for the District of Minnesota. The Appellants countered by filing a proof of claim and initiating a non-discharegability action, with a demand for a jury trial, for the damages owed on their copyright infringement claim.

The Bankruptcy Court struck the Appellant's jury demand, awarded the minimum $14,250 in statutory damages, deemed the award non-dischargeable, and denied the Appellant's motion for over $90,000 in attorney's fees. The Appellant's appealed the court's decision with regard to the jury trial and the attorney's fees to the District Court for the District of Minnesota, which affirmed the Bankruptcy Court. Appeal to the Eighth Circuit Followed.

The Eighth Circuit began by stating that the Appellant's waived their right to a jury trial by filing their proof of claim. The court referenced, and applied, the landmark Supreme Court Case of Katchen v. Landy, 382 U.S. 323 (1966), Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989), and Langenkamp v.

Culp, 498 U.S 42 (1990), and found that when the Appellant's filed their proof of claim, they submitted themselves to the bankruptcy court's claims allowance process. Therefore, the accompanying adversary proceeding was triable only in equity, and not subject to the right to jury trial. Although the Appellant's argued that Stern v. Marshall, 131 S.Ct. 2594 (2011) casted doubt on the applicability of the preceding cases, the Eighth Circuit found that Stern distinguished Katchen and Langenkamp as cases in which resolution of the ensuing action was integral to the claims allowance process, which was clearly the case at bar.

Finally, though 17 U.S.C. § 505 allows a court to award attorney's fees to the prevailing party in a copyright infringement action, the Bankruptcy Court did not abuse its discretion in denying the Appellant's motion. The Appellants could have easily stopped the Appellee's actions with a simple cease- and desist-letter, they filed suit in the busiest and largest court they could find, they resisted settlement efforts, and they pursued an expensive strategy in light of the absence of any real damages. The Appellant's were certainly free to pursue any strategy they wished, and at any cost, but they were never assured that their attorney's fees would be compensated under the permissive statute.