Bankruptcy Bulletin

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IN THIS ISSUE

B.A.P. Finds Tax Injunction Act Bars Bankruptcy Court From Exercising Jurisdiction

In United Taconite, LLC v. State of Minnesota (In re Eveleth Mines, L.L.C.), No. 04-6045/04-6048 (8th Cir. B.A.P. December 23, 2004) the 8th Circuit B.A.P reversed a ruling in favor of the State of Minnesota on the grounds that the Tax Injunction Act barred the Bankruptcy Court from exercising jurisdiction

Cleveland Cliffs, Inc., and Laiwu Steel Group, Ltd., formed United Taconite, LLC ("United Taconite"), in order to bid on the sale of Eveleth Mines, L.L.C. d/b/a EVTAC Mining and Thunderbird Mining Co. ("Debtor"). On October 29, 2003, the Court approved a set of procedures for soliciting bids. At all times, the Minnesota Department of Revenue ("MDOR") had notice and appeared in the case. On November 7, 2003, United Taconite filed an Asset Purchase Agreement (the "Agreement") with the Bankruptcy Court (the "Court"). United Taconite agreed to pay cash in the amount of $3 million and to assume nearly $40 million in liabilities. The Court approved the Debtor's sale of its operating assets to United Taconite and entered an order approving the sale on November 26, 2003 (the "Order").

In pertinent part, the Agreement states that United Taconite shall not assume or pay any of the Debtor's liabilities, including "any taconite production tax attributable to the mining and beneficiation of taconite ore into enriched iron ore pellets that has been or may be assessed by any Taxing authority, including but not limited to the Minnesota Department of Revenue...." The Order contains a similar provision to the one in the Agreement, quoted above, and explicitly states that United Taconite is not to assume any taconite production tax assessed for any taconite production by the Debtor pursuant to section 298.24-298.27 of the Minnesota Statutes. The Order also states that "Pursuant to §§ 105(a) and 363(f) of the Bankruptcy Code, the Debtor is authorized to transfer title to the Mining Assets to the Buyer free and clear of (a) all interests, pledges, liens...obligations for the payment of taconite production taxes related to the mining and production operations by [the] Debtor using the Mining Assets, on [sic] restrictions or charges of any kind or nature whatsoever...." The Order was entered without objection from any party and was not appealed. The sale was closed.

MDOR assessed a taconite production tax against United Taconite based, in part, on the Debtor's production. United Taconite, believing that such an assessment violated the Order, immediately filed a motion seeking to enforce the Order, claiming that both the Agreement and the Order specifically prohibited MDOR from using any taconite production of the Debtor in its taconite production tax assessed against United Taconite.

The Court determined that it had jurisdiction to interpret and enforce the Order because it had jurisdiction to enter the Order. The Court then found that this jurisdiction was not barred by the Tax Injunction Act because there was not a plain, speedy, and efficient remedy in state court. It held there was no "plain" remedy in state court because there was uncertainty concerning the availability or effect of a remedy for a federal law issue, namely the application of section 363(f) of the Bankruptcy Code. Furthermore, the administrative agency track and judicial track under Minnesota procedure were not speedy or efficient. The administrative agency track lacked a remedy for the alleged wrong identified by United Taconite, and there was too much uncertainty for a prompt and efficient adjudicated resolution under

the judicial track. Based on these findings, the Court found it had full authority to address United Taconite's motion. *Id.* at 19.

The Court then held that Minnesota's taconite production tax scheme and its application by the Minnesota Department of Revenue did not create, recognize, or enforce an "interest" in property that was subject to 11 U.S.C. § 363(f). The Court also held that the terms of the asset sale order itself did not foreclose the Minnesota Department of Revenue from applying the statutory averaging formula

The Bankruptcy Appellate Panel for the Eighth Circuit (the "Panel") starting by noting that the question of subject matter jurisdiction is subject to *de novo* review The Panel went into an in-depth analysis on the Tax Injunction Act (the "Act"), ultimately concluding that the Act barred the Court from exercising jurisdiction. The Panel agreed with United Taconite's argument that the Court has jurisdiction to interpret and enforce the Order because the Court had jurisdiction to enter the Order The Panel then pointed out that the Act is a rule of abstention, not jurisdiction. The Panel therefore defined the issue as not whether the Court had jurisdiction, but whether the Act required the Court to abstain from exercising that jurisdiction.

In finding that the Act barred the Court from exercising jurisdiction, the Panel determined that because the Act was triggered through the relief sought by United Taconite, the Court could only exercise jurisdiction if a plain, speedy, and efficient remedy could not be had in State Court. Disagreeing with the Bankruptcy Court, the Panel determined that the Minnesota courts were indeed a plain, speedy, and efficient forum for a couple of reasons. First, under the Erie Transfer Procedure, the Tax Court can transfer any constitutional issues to the state District Court, which then decides the issue or refers it back to the Tax Court for a decision. In other words, the Tax Court and District Court have jurisdiction to decide all of the issues raised in United Taconite's motion.

Second, the Panel found unpersuasive United Taconite's argument that Minnesota courts may not give proper deference to the effect of a section 363 sale under the Bankruptcy Code. "A taxpayer's lack of confidence in the state court process is not…the standard to be applied." United Taconite did not prove that the Minnesota Procedure was not plain, speedy, and efficient, and therefore the matter was remanded to the Court to enter an order abstaining in favor of the Minnesota courts.

Post-Petition Presentment Of Post-Dated Checks Does Not Violate Automatic Stay

In Thomas v. Money Mart Financial Services, Inc. (In re Thomas), No. 04-6038WM (8th Cir. B.A.P. December 10, 2004) the Bankruptcy Appellate Panel for the Eighth Circuit held that a pay day lender's post-petition presentment of post-dated checks which it received from a debtor is excepted from the automatic stay pursuant to Bankruptcy Code Section 362(b)(11) The panel agreed with the Bankruptcy Court that, under Missouri law, the lender was entitled to enforce the checks. Therefore, the lender's demand for payment constituted presentment covered by the exception to the automatic stay.

On November 15, 2003, the Debtor obtained four pay day loans from Money Mart Financial Services, Inc., ("Money Mart") each in the amount of $50.00. In exchange, the Debtor gave Money Mart four checks, each in the amount of $77.00, post-dated December 15, 2003. It was the party's expectation that the Debtor would be paid on or about that date, which would provide sufficient funds for the checks to be paid

On November 18, 2003, the Debtor filed a chapter 7 petition. On the same date, her attorney sent Money Mart a notice indicating that the Debtor had filed a bankruptcy petition. Money Mart also received a court notice regarding the commencement of the Debtor's case.

On December 17, 2003, the four checks were presented for payment to the Debtor's bank. On January 15, 2004, the Debtor filed a complaint under Section 362(h) based on her claim that Money Mart had violated the automatic stay when it presented her checks for payment. After trial, the Bankruptcy Court held that Money Mart's actions in presenting the checks were excepted from the automatic stay pursuant to Section 362(b)(11).

The Bankruptcy Court further held that the payment of the checks was an unauthorized post-petition transfer avoidable by the Trustee under Section 549(a). The Court, however, did not award the Debtor damages for violation of the automatic stay, but did order Money Mart to return the sum of $308.00 to the Debtor. The Debtor appealed.

This case revolves around the applicability of Section 362(b)(11), which excepts from the automatic stay "the presentment of a negotiable instrument and the giving of notice of and protesting dishonor of such an instrument." The parties agreed that the four checks were negotiable instruments. At issue was whether or not what Money Mart did constitutes "presentment" of the checks

The Court stated that at first blush, "The answer seems obvious. Under any commonly understood use of the word 'presentment,' that is exactly what Money Mart did. In order to obtain payment of the checks, it presented them, either directly or indirectly, to the debtor's bank." However, the Court noted that there is no definition of "presentment" in the bankruptcy code. The court looked to Missouri law (the U.C.C.) which defines "presentment" as:

> "A demand by or on behalf of a person *entitled to enforce an instrument* (i) to pay the instrument made to the drawee or a party obliged to pay the instrument, or in the case of a note or accepted draft payable at a bank, to the bank, or (ii) to accept a draft to the drawee. Mo. Rev. Stat. Section 400.3-501(a) (emphasis added)."

Missouri law further provides:

> "Except as stated in subsection (b), the right to enforce the obligation of a party to pay an instrument is subject to the following: (1) a defense of the obligor based on . . . (iv) *discharge of the obligor in insolvency proceedings*. Mo. Rev. Stat. Section 400.3-305(a)(1)(iv) (emphasis added)."

The Missouri statute clearly states that, if an obligor has received a discharge in bankruptcy, the holder of a negotiable instrument is no longer a person entitled to enforce it. When Money Mart presented the checks, the Debtor had not received her discharge, and whether she would or not was uncertain. The Court noted that some courts have suggested that, "The fact that the debt may later be discharged, brings into play the Missouri statute vitiating the holders status as a person entitled to enforce an instrument."

However, the Court said, "We simply cannot agree. The statute says nothing of the kind and such a reading would virtually destroy the applicability of the exception to the automatic stay and is certainly inconsistent with its language. It would put presenters of checks in the

position of trying to make judgments about whether or not debtors *would* receive a discharge in the future and, if so, whether or not the debtor's debt to it would excepted from such a discharge." That analysis is highly impracticable and would render the exception to discharge "virtually meaningless."

Livestock Owner/Contractor Held To Be Farmer

In Coop. Supply, Inc. v. Corn-Pro Nonstock Coop., Inc., (In re Corn-Pro Nonstock Coop., Inc.), No. 04-6070/6071/6072 NF (8th Cir. B.A.P. December 16, 2004), the B.A.P. affirmed the Bankruptcy Court finding that the Debtor was a farmer not subject to an involuntary petition. Further, the B.A.P. affirmed the denial of sanctions against the petitioning creditors.

In an earlier decision in the Corn-Pro case, the B.A.P. refused to hear the parties' cross-appeals, ruling that they were interlocutory. The appeals arose from an involuntary bankruptcy petition. The Debtor, Corn-Pro, filed a motion to dismiss alleging that it was a "farmer" within the meaning of Bankruptcy Code § 101(20) not subject to an involuntary filing. Thereafter, the parties filed cross-motions for summary judgment. The Bankruptcy Court granted Corn-Pro's motion for summary judgment, denied the motion of the petitioning creditors, and subsequently denied a motion by Corn-Pro seeking attorneys' fees and costs pursuant to Bankruptcy Code § 303(i)(1) and (2). Corn-Pro appealed the order denying its motion for attorney fees and costs, and the petitioning creditors appealed the order granting summary judgment in favor of Corn-Pro. The B.A.P. determined that both appeals were interlocutory in nature because the Bankruptcy Court had failed to rule on Corn-Pro's motion to dismiss. This decision was explored in an earlier Bankruptcy Section Newsletter.

After the dismissal of the appeals, the Bankruptcy Court entered an order dismissing the case, based upon its prior determination that Corn-Pro was a farmer within the meaning of the Bankruptcy Code. The parties again filed cross-appeals.

Bankruptcy Code § 303(a) provides that an involuntary petition may only be commenced "against a person, except a farmer . . ." 11 U.S.C. 303(a). Corn-Pro is a Nebraska nonstock cooperative association: a corporation for the purposes of Nebraska law and thus a "person" for the purposes of the Bankruptcy Code. 11 U.S.C. § 101(41) (defining a person to include corporations). Bankruptcy Code § 303 provides that a person can be a farmer if more than 80 percent of such person's income comes from a farming operation. All of Corn-Pro's income was derived from livestock production. The B.A.P. thus maintained that the issue was whether the livestock production that Corn-Pro was involved in was a "farming operation" within the meaning of Bankruptcy Code § 101(21).

Corn-Pro's business involved buying pigs from a farrower, contracting with hog producers and arranging, through independent-contractor managers, for third parties to transport the pigs to producers' facilities. The producers fed and raised the pigs and when ready for slaughter, Corn-Pro sold the pigs to packers and hired trucking companies to ship the hogs to the packers. A prior 8th Circuit case, Otoe Co. Nat'l Bank v. Easton (In re Easton), 883 F.2d 630 (8th Cir. 1989), had held that a passive investor, with no connection to the production of crops or livestock, is not engaged in farming operations. The petitioning creditors argued that Corn-Pro was merely a passive investor because,

while Corn-Pro owned the pigs, it hired third parties to raise and finish them, and Corn-Pro was managed by independent contractors and had no employees.

The B.A.P. disagreed. The Court noted that the independent contractors were Corn-Pro members who managed the operations as representatives of and on behalf of Corn-Pro. Thus, the Court concluded that Corn-Pro was not a passive investor: it had significant involvement in raising the pigs, the sale of which generated all of Corn-Pro's income. The B.A.P. determined that the Bankruptcy Court's finding that Corn-Pro was a farmer within the meaning of the Bankruptcy Code was correct and that the Bankruptcy Court had therefore properly dismissed the involuntary petition.

Bankruptcy Code § 303(i)(1) provides that the bankruptcy court "may" grant judgment against petitioners in favor of the debtor for attorney's fees and costs where the court dismisses the petition other than on the consent of all petitioners and the debtor. The Bankruptcy Court declined to exercise its discretion to award fees and costs to Corn-Pro based upon its determination that the legal issue of whether Corn-Pro was a "farmer" was "a very close question." The B.A.P. agreed and found no abuse of discretion in the Bankruptcy Court's denial of Corn-Pro's motion seeking its attorneys' fees and costs.

B.A.P. Upholds Sanction Against Attorney for E-Filing Petition Without Obtaining Debtor's Signature

In Briggs v. LaBarge (In re Phillips), No. 04-6025EM (8th Cir. B.A.P. November 24, 2004), the Bankruptcy Appellate Panel upheld the Bankruptcy Court's order requiring Debtor's attorney to return all funds received from the Debtor, pay a fine of $750 to the Court, payment of $300 for the trustee's attorneys' fees and deliver a copy of the Court's findings to the office of the chief disciplinary counsel and the United States Attorney for the Eastern District of Missouri.

On October 20, 2003, the Debtor filed a Chapter 13 petition with her attorney Leon Sutton of Critique Legal Services. The case was dismissed on November 5, 2003 for failure to file a plan. On December 5, 2003, Ross H. Briggs, another attorney at Critique Legal Services, electronically filed a second Chapter 13 petition for the Debtor. The Debtor did not sign the petition, did not give Briggs permission to file a second petition and had never even spoken to Briggs. On December 29, 2003, while the second case was still pending, the Debtor retained another attorney and filed a third Chapter 13 petition. At the request of the Trustee in the second case, the Bankruptcy Court dismissed the second case on January 14, 2004.

Shortly thereafter, the Trustee filed a motion pursuant to Rule 9011 for sanctions against Briggs for electronically filing a petition without obtaining the Debtor's signature. The Bankruptcy Court granted the Trustee's motion for sanctions and held that: (1) Briggs filed a document for which he did not have an original signature of the debtor in violation of Rule 9011 and local procedures, (2) Briggs filed a petition for a debtor with whom he did not meet in violation of Walton v. LaBarge (In re Clark), 223 F.3d 859 (8th Cir. 2000); and (3) Briggs filed a false disclosure of compensation of attorney for debtor form claiming that the debtor paid him $99 for his services when she had not. Briggs appealed the Bankruptcy Court order arguing that Rule 9011 does not require the Debtor's signature on a petition.

In affirming the Bankruptcy Court, the B.A.P. noted that it is the official bankruptcy petition, not Rule 9011, requires

a debtor's signature to verify the facts contained in the petition. In addition, the case management/electronic case filing (CM/ECF) administrative procedures manual for the Bankruptcy Court for the Eastern District of Missouri, requires that all petitions be filed electronically and that the debtor's electronic signature appear on all voluntary petitions. The B.A.P. noted that CM/ECF procedure indicates, "the filing or submission of a document required to be signed by another person is the filers representation that the party whose signature is required has in fact signed the document." The Bankruptcy Appellate Panel found that Briggs violated Rule 9011 by inserting the Debtor's signature and filing it itself indicating that the Debtor had signed it in accordance with local procedure when the Debtor had in fact not signed the document.

B.A.P. Reverses Non-Dischargeable Determination

In Waring v. Austin (In re Austin), No. 04-6035 (8th Cir. B.A.P. 2004), the 8th Circuit B.A.P. reversed the Bankruptcy Court's ruling that a debt was excepted from discharge pursuant to 11 U.S.C. § 523(a)(2)(A).

The Debtor was the president and majority shareholder in a jewelry store in Missouri (the "Jewelry Store"). The Creditor was interested in buying stock in the Jewelry Store from the Debtor. He retained an attorney to help him negotiate a stock purchase agreement. During negotiations, the Creditor asked the Debtor to disclose all assets and liabilities of the Jewelry Store. The lists for assets and liabilities were supposed to be incorporated as exhibits in the stock purchase agreement. However, the Debtor never produced these lists for the Creditor to review. The Creditor decided to purchase the stock even though he did not receive these important disclosures. On February 4, 2000, the Creditor purchased 125 shares of the Jewelry Store from the Debtor for $100,000.00. The stock purchase agreement stated that under certain circumstances, the Creditor could demand that the Debtor repurchase the 125 shares plus a 10% return on the investment.

At the time of the stock purchase, the Debtor told the Creditor that the Jewelry Store was obligated to repay a loan in the amount of $362,000.00 that was used to purchase store furniture, fixtures, and to remodel the store. A few days after the Creditor had purchased his stock, the $362,000.00 loan was refinanced and the Debtor granted the new lender a blanket security interest on all assets of the Jewelry Store, including the jewelry. The grant of a blanket security interest on all of the assets of the Jewelry Store was not disclosed to the Creditor.

After the stock purchase, the Creditor took over the accounting practices for the Jewelry Store. Approximately one year after the stock purchase, the Creditor discovered that the Jewelry Store's corporate status had been dissolved and that there had been outstanding debts previously undisclosed to him. After learning this and other accounting irregularities, the Creditor demanded that the Debtor repurchase his stock from him. The Debtor could only come up with $26,000.00 to repurchase the stock. The Creditor, unsatisfied, demanded that he be paid by jewelry for his investment. It was at this time that the store manager, who is not the Debtor, told the Creditor that a bank holds a security interest in all of the jewelry in the store. Undaunted by this news, the Creditor continue to demand his payment in jewelry. After a couple of rounds of negotiation, the parties agreed upon the proper selection of jewelry that would satisfy the Creditor.

The Debtor continued making payments to the bank following this episode. However, within a year of the Creditor taking the jewelry from the store, the Debtor could not continue his business and filed for bankruptcy. The bank filed a replevin action against the Creditor for the return of the jewelry. The parties settled the matter by the Creditor agreeing to pay $25,000.00 and to return jewelry valued at $77,000.00 to the bank.

Following the bank's replevin action, the Creditor instituted a 11 U.S.C. 523(a)(2)(A) non-dischargeability action against the Debtor seeking to except $102,000.00 from discharge under the theories of false pretenses, false representation, or actual fraud. To prevail in a non-dischargeability action under Section 523(a)(2)(A), a creditor must prove by a preponderance of evidence that: (1) the debtor made a false representation; (2) at the time the debtor knew the representation to be false, (3) the debtor made the representation deliberately and intentionally with the intention and purpose of deceiving the creditor; (4) the creditor justifiably relied on the representation; and (5) the creditor sustained loss and damage as a proximate result of the representation having been made. The Bankruptcy Court found that the Creditor has satisfied these elements. The Debtor appealed to the 8th Cir. B.A.P., specifically contending the first, third, and fourth elements: false representation, intent to deceive, and justifiable reliance.

The determination of whether a requisite element of a claim under Section 523(a)(2)(A) is present is a factual determination which appellate courts review for clear error.

The Creditor's case relied on the theory that the Debtor did not disclose that a bank had a lien on the jewelry that was given to the creditor to satisfy his debt. The Debtor claimed the Creditor did not justifiably rely on the omission. The 8th Cir. B.A.P. in discussing what constitutes justifiable reliance stated that "...[a] person is 'required to use his senses, and cannot recover if he blindly relies upon a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation.'" In finding that the Creditor cannot prove by a preponderance of evidence that his reliance was justifiable the 8th Cir. B.A.P. cited to: (1) the Creditor's willingness to purchase the stock without seeing the complete list of the corporate liabilities; (2) the Creditor was represented by counsel during the negotiation of the stock purchase agreement, (3) after the purchase the Creditor had discovered liabilities which the debtor had not disclosed, and (4) the testimony by the store manager that the bank held a security interest in the jewelry. Because the Creditor's reliance was not justifiable, the 8th Cir. B.A.P. reversed and did not reach the remaining issues on appeal.

Court Initiated Sanctions Upheld

In Cruz v. Conseco Finance Servicing Corp. (In re Crofford), No. 04-6029EA (8th Cir. B.A.P. December 14, 2004), the B.A.P. affirmed the Bankruptcy Court's Order imposing sanctions on Kathy A. Cruz, counsel for the Debtors. In her appeal, the Debtors' counsel claimed that the decision of the Eighth Circuit Court of Appeals, Norsyn, Inc. v. Desai, 351 F.3d 825 (8th Cir. 2003), dictated a vacation of sanctions.

Cruz suggested that the sanctions had to be vacated in their entirety when a trial court improperly awards attorneys' fees to an aggrieved party where the Court, not the aggrieved party, initiated the imposition of the sanctions. The B.A.P. agreed that only sanctions initiated by motion of an

aggrieved party may be payable to the movant. Sanctions imposed on a Court's initiative must be paid to the Court pursuant to Federal Rule of Bankruptcy Procedure 9011(c)(2). However, in this case, the Bankruptcy Court modified its earlier order and determined that the sanctions previously imposed on Cruz and payable to Conseco should be made payable to the Court. Accordingly, the B.A.P. affirmed.

NEWS

St. Paul Bankruptcy Court To Move

On or near June 20, 2005, the Bankruptcy Court in St. Paul will move to Minneapolis while the St. Paul Warren Burger Federal Building is renovated. The renovation will take approximately 2 years. At this time, the plan is for Judge Kishel to share Judge Dreher's courtroom and Judge O'Brien to share Judge Kessel's. First meetings will continue in St. Paul at a location to be named. More details will follow.

Chapter 13 Office News

The Chapter 13 office held another in its series of Brown Bag Lunches on Friday, January 21. This meeting was designed for legal assistants only and, despite the inclement weather, some 20 legal assistants attended, from as far away as Waseca, Owatonna, Mankato and St. Cloud. The attendees heard a presentation on drafting schedules and plans for accuracy and completeness, followed by a tour of the Chapter 13 office and an opportunity to meet Jasmine Keller's staff.

Ms. Keller attended the midyear meeting of the National Association of Chapter 13 Trustees in Washington, D.C. January 27 -29.

Newly-appointed Milwaukee, WI Chapter 13 Trustee Mary Grossman visited the Chapter 13 offices on Thursday, January 20, to view the operations and to get a first hand look at the specialized software used by the Chapter 13 office.

New Panel Trustee Named in Duluth

The U.S. Trustee Office has announced that Bridget Brine has been named a new panel chapter 7 trustee in Duluth. Her contact information follows:

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