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IN THIS ISSUE

TRUSTEE'S MOTION TO SELL HOUSE UNDER SECTION 363 DENIED BECAUSE DETRIMENT TO THE CO-OWNER WOULD HAVE OUTWEIGHED ANY BENEFIT TO THE ESTATE

In the Chapter 7 case of *Lovald v. Tennyson (In re Wolk)*, No. 11-2737 (8th Cir. July 30, 2012), the bankruptcy court and the BAP denied a chapter 7 trustee's motion under 11 U.S.C. § 363(b) to sell a home that the debtor owned as a tenant in common with his non-debtor wife, and the Eighth Circuit affirmed.

Pursuant to 11 U.S.C. § 363(h)(3), when a trustee and a co-owner both possess an interest in property, the estate may not proceed to sell the asset unless "the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners." In *Lovald*, the court noted that noneconomic factors can be considered when evaluating detriment to the co-owner. The court then weighed the potential benefit to the estate against the detriment to the debtor's wife, and held that the lower courts had not abused their discretion in denying the sale motion.

The court first considered the potential benefit to the estate. The bankruptcy court had found that a sale could generate approximately $31,000 from the equity in the home minus liquidation costs. Even assuming for the sake of analysis that the trustee would be entitled to half the equity, the court agreed that the trustee failed to show that the estate would reap substantial benefits from the sale.

The court then held that the detriment the wife would suffer as a result of the sale would be substantial for the following reasons: all of the equity in the home was attributable to the wife's financial contributions, the equity in the home would accrue to her under South Dakota state law, the debtor's wife would be burdened by having to finance a new house and pay relocation costs, and the debtor's wife had a long history of depression and her therapist opined that the condition would worsen if the house were sold. Thus, the court concluded that the lower courts had properly balanced the equities, and affirmed the denial of the sale motion.

DEBT DEEMED NONDISCHARGEABLE UNDER 11 U.S.C. § 523(a)(2)(A)

In the Chapter 7 case of *Heide v. Juve (In re Juve)*, Adv. No. 09-6057 (Bankr. D. Minn. Sept. 28, 2012), the court held that a debt was nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A).

The plaintiff worked for the debtor at a used car dealership. Each was working as an independent contractor, though the debtor later became part owner of the dealership. The debtor approached the plaintiff about funding the purchase of vehicles to be sold at the dealership. The plaintiff agreed to finance purchases, initially financing the purchase of used cars to sell one car at a time. Interest was to be paid while the car was on the lot and the principal was to be re-paid upon the sale of the car.

Eventually, the plaintiff agreed to the debtor's request to change the financing terms such that the loaned funds, rather than being repaid upon a car sale, would be re-invested into additional cars, and the plaintiff would receive a flat monthly interest rate on the total outstanding balance. The debtor represented to the plaintiff that the plaintiff owned the cars on the lot free and clear, and that the plaintiff could collect on his investments without a loss at any time by simply liquidating the vehicles. In reality, however, the debtor encumbered the vehicles knowing he was compromising the plaintiff's interest in the vehicles and that he was misrepresenting the equity in the vehicles. The debtor also misused the loaned funds by paying expenses other than unencumbered vehicle purchases. The other owner of the dealership did not know of the financing arrangement between the debtor and the plaintiff.

The court held that the corporate veil, if any existed here, could be pierced to hold the debtor personally liable for the amounts owed to the plaintiff, due to the fundamental unfairness of a determination that the dealership, rather than the debtor, was the actual borrower from the plaintiff. The court then held that the elements of § 523(a)(2)(A) were met, such that the amount owed to the plaintiff was nondischargeable in the debtor's bankruptcy case.

DEBT HELD TO BE "IN THE NATURE OF" CHILD SUPPORT AND THUS NONDISCHARGEABLE UNDER § 523(a)(5)

In the Chapter 7 case of *Lakeman v. Weed (In re Weed)*, Adv. No. 12-3064 (Bankr. D. Minn. Sept. 18, 2012), the court held that a debt was nondischargeable pursuant to 11 U.S.C. § 523(a)(5).

The plaintiff and the debtor are the parents of a minor child, but were never married. The plaintiff is a citizen and resident of Canada, and the debtor is a citizen and resident of the United States. Following the plaintiff's commencement of a proceeding under the International Child Abduction Remedies Act (ICARA), the United States District Court awarded the plaintiff physical custody of the child, and ordered the debtor to pay a certain portion of the plaintiff's attorney's fees and costs. When the debtor subsequently filed a bankruptcy case, the plaintiff commenced an adversary proceeding seeking a determination that the attorney's fees awarded in the ICARA case were nondischargeable pursuant to § 523(a)(5) or § 523(a)(15).

The court held that § 523(a)(15) did not apply. While it excepts from discharge debts "to a spouse, former spouse, or child of the debtor," the debt in question was owed to the plaintiff, who was not a spouse or former spouse of the debtor. The court then turned to § 523(a)(5), which excepts from discharge debts for "domestic support obligations," a term given a specific definition in § 101(14A).

As an initial matter, the court held that the attorney's fees at issue met some of the requirements to be a domestic support obligation because they were owed to the parent of a child of the debtor, and were established by court order. The main issue was whether the attorney's fees met another element of the "domestic support obligation" definition: that the debt be "in the nature of alimony, maintenance, or support" of the child or child's parent.

The court concluded that the facts and circumstances established that the attorney's fees were "in the nature of" child support. Noting that the statutory definition specifically states that the debt need not be expressly designated child support to qualify, the court determined the "nature" of the award by analyzing the function it was intended to serve. The court found that the award of attorney's fees was intended to restore the plaintiff and the child to the status quo; specifically, instead of devoting funds to pay her attorney, the plaintiff would be able to devote such funds to supporting the child. As a result, the court held that the attorney's fees owed to the plaintiff were a debt that was nondischargeable in the debtor's bankruptcy case by operation of § 523(a)(5).

ORDER IMPOSING SANCTIONS AND REQUIRING DISMISSAL OF STATE COURT ACTION FOR VIOLATION OF DISCHARGE INJUNCTION

In *Williams v. King (In re King)*, No. 12-6014 (B.A.P. 8th Cir. Oct. 9, 2012), the BAP affirmed a bankruptcy court order requiring a creditor and his attorney to: (i) dismiss a lawsuit that sought to collect on a discharged debt, and (ii) pay sanctions to the debtor in the form of attorney's fees.

The creditor, although he had made prepetition loans to the debtor, was not originally listed in the debtor's schedules. After the debtor received a discharge, the case was closed, and a report of no distribution was filed, the debtor filed a motion to reopen the case to add creditors, including the creditor at issue. The creditor filed an objection to the motion to reopen, arguing that the debtor had agreed not to list him in the bankruptcy case in exchange for the creditor's agreement to provide additional postpetition funding to the debtor. Accordingly, the creditor argued, the debtor should not be allowed to discharge his debt because the debt was "re-incorporated" when the creditor provided postpetition funding. The creditor's attorney appeared at the hearing on the motion, at which the bankruptcy court overruled the objection, reopened the case to add the creditors, and then re-closed the case.

Approximately one month later, the creditor, represented by the same attorney, sued the debtor in state court. On a motion by the debtor, the bankruptcy court re-opened the case, and the debtor filed a motion asserting that the state court action violated the discharge injunction and seeking sanctions. The motion was served on the creditor's attorney. The attorney did not respond, however, and the bankruptcy court entered an order finding a violation of the discharge injunction and ordering the attorney to pay damages and dismiss the state court action.

Following various motions to reconsider, one of which was appealed, the BAP held that: (i) the debt at issue in one count of the state court action included at least some amounts owed prepetition, and those amounts were not made into a postpetition obligation by the "re-incorporation," because it did not comply with the reaffirmation rules of § 524(c); (ii) the prepetition debt was discharged; and (iii) notice of the motion for sanctions was proper because, although notice was not served on the creditor, it was served on the attorney-appellant, who had become the proper party to receive notice by appearing in the bankruptcy case. The BAP later affirmed the bankruptcy court's orders that the state court action relating to the discharged debt be dismissed, and that sanctions in the form of attorney's fees be imposed on the creditor and his attorney.

DEBTORS COULD NOT PROVIDE FOR SPECIAL TREATMENT OF NON-PRIORITY TAX DEBT IN THEIR CHAPTER 13 PLAN

In the case of *Copeland vs. Richard Fink* (*In re Copeland*), No. 12-6034, (8th Cir. B.A.P. 2012), the debtors objected to their own Chapter 13 plan because it did not provide for special treatment of their non-priority tax debt and payment of their tax preparation fees. Their original plan contained provisions which provided for both, but that plan was denied confirmation. The debtors then proposed a plan without these provisions and objected to it. The bankruptcy court confirmed the revised plan over the debtors' objection and the debtors appealed.

On appeal, the BAP held that the bankruptcy court's confirmation of the debtors' plan was proper and that the bankruptcy court had therefore properly overruled the debtors' objection. More specifically, the BAP held that the debtors' separate classification of unsecured non-priority tax claims would violate 11 U.S.C. § 1322(b)(1) because it would unfairly discriminate against the other unsecured creditors. In making this determination, the BAP analyzed the four-factor standard adopted by the Eighth Circuit Court of Appeals: (1) whether the discrimination has a reasonable basis; (2) whether the debtor can carry out a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) whether the degree of discrimination is directly related to the basis or rationale for the discrimination. *Mickelson v. Leser* (*In re Leser*), 939 F.2d 669, 672 (8th Cir. 1991).

The BAP found that the debtors' reasons for seeking special treatment of the tax debt – i.e., that they wanted to avoid the punishment of the tax creditors and satisfy nondischargeable debt – did not constitute a reasonable basis for the proposed discrimination. The BAP therefore affirmed the bankruptcy court's decision to confirm the debtors' modified Chapter 13 plan.

DEBT IS NONDISCHARGEABLE WHERE A BANK REASONABLY RELIES ON WRITTEN STATEMENTS AND A DEBTOR'S STATE LAW COUNTERCLAIMS CAN BE RESOLVED BY THE BANKRUPTCY COURT

In the case of *Bank of Nebraska v. Rose, et al.* (*In re Rose*), No. 12-6046, (8th Cir. B.A.P. 2012), the debtor appealed the bankruptcy court's order determining that the debt he owed to Bank of Nebraska was nondischargeable and denying the debtor's counterclaim.

The two issues addressed on appeal were (i) whether the bankruptcy court used the correct standard in determining that Bank of Nebraska reasonably relied on the Debtor's written statements such that the debt at issue could be deemed nondischargeable under 11 U.S.C. § 523(a)(2)(B), and (ii) whether the bankruptcy court had jurisdiction to enter a final judgment with respect to the debtor's counterclaim.

With respect to the first issue, the debtor argued that the bankruptcy court erroneously applied a "subjective justifiable reliance" standard in determining whether the Bank was reasonable in relying on his written financial statements to extend credit. The BAP held that the bankruptcy court did not reference the "subjective justifiable reliance" standard anywhere in its memorandum order, but instead cited and applied the proper "reasonable reliance" standard, which requires analysis of the totality of the circumstances.

With respect to the second issue – whether or not the bankruptcy court had jurisdiction to decide on the Debtor's state court counterclaims under *Stern v. Marshall*, ___ U.S. ___, 131 S.Ct. 2594 (2011) – the BAP indicated that the debtor's citation of this case raised an issue of the bankruptcy court's constitutional authority to decide the debtor's counterclaims as opposed to a jurisdictional issue. The BAP then held that the debtor consented to the bankruptcy court's entering a final judgment on his counterclaims and that he lacked standing to pursue the appeal on the counterclaims in any event because the claims belonged to his bankruptcy estate and any recovery would enure exclusively to the benefit of creditors as opposed to the debtor himself.

A CONTRACTOR'S FAILURE TO TURN PROCEEDS OVER TO ITS SUBCONTRACTORS DOES NOT CREATE A NONDISCHARGEABLE DEBT

In *Reshetar Systems, Inc. v. Thompson* (*In re: Scott Alfred Thompson and Kirsten Marie Thompson*), No. 11-3397 (8th Cir., July 30, 2012), the debtor was the sole owner and president of a construction company serving as the general contractor hired to construct an Applebee's restaurant. The creditor was a subcontractor that agreed to provide the labor, materials, skills, and equipment necessary to perform carpentry and drywall work for the project.

The creditor performed its end of the bargain in full, completing its work in January 2004. Despite being paid most of what it claimed it was owed from Applebee's, the debtor's company failed to pay the creditor $48,293.81 of the total it was owed. The creditor filed a lawsuit against the debtor and the debtor's company, and in June 2009, the debtor confessed judgment in the amount of $78,000.

The debtor filed a Chapter 7 bankruptcy petition in December 2009. The creditor commenced an adversary proceeding pursuant to 11 U.S.C. § 523(a)(2)(A), (4) and (6) to determine the dischargeability of the $78,000 owed by the debtor. The matter was tried, and on January 20, 2011, the bankruptcy court entered judgment in favor of the debtor. The creditor appealed, although it abandoned the claim asserted under 11 U.S.C. § 523(a)(2)(A). The BAP affirmed, holding the creditor failed to establish the debt was nondischargeable pursuant to 11 U.S.C. § 523(a)(4) and (a)(6).

The Eighth Circuit affirmed, holding that, with respect to the § 523(a)(4) claim, the creditor failed to establish the existence of a fiduciary relationship arising from a requisite express or technical trust. The Eighth Circuit further reasoned that to meet the requirements of § 523(a)(4), the trust must include a definable res and impose "trust-like" duties and that the language of Minn. Stat. § 514.02, upon which the creditor was relying to establish the alleged trust, did not create the requisite fiduciary capacity. Accordingly, no actual "trust" had been created.

The Eighth Circuit likewise rejected the creditor's common law theory that when the debtor's company became insolvent, the debtor owed the creditor certain common law fiduciary duties. The alleged common law fiduciary duty was not cognizable under § 523(a)(4) and the creditor failed to prove any self-dealing, which was the only harm that the common law intended to protect.

Finally, the Eighth Circuit affirmed the BAP's determination with regard to the creditor's § 523(a)(6) claim because the debtor's failure to pay the creditor its portion of the proceeds obtained from Applebee's did not meet the standard required to establish a willful and malicious injury. In so doing, the Eighth Circuit rejected the creditor's theory that the debtor and his company were guilty of theft and conversion of the creditor's property.

EIGHTH CIRCUIT AFFIRMS THAT FAILURE TO RECEIVE MONEY OR PROPERTY CONCURRENT WITH ALLEGED MISREPRESENTATIONS IS FATAL TO DISCHARGEABILITY COMPLAINT

In *The Samuel J. Temperato Revocable Trust v. Unterreiner* (*In re Unterreiner*), No. 11-6039 (BAP 8th Cir., Nov. 18, 2011), the debtor and another individual were the sole shareholders of a franchisee, a corporation that owned and operated at least three Dairy Queen restaurants pursuant to a franchise agreement with the franchisor, which is a separate corporation wholly owned by a trust.

By December 2005, the franchisee was experiencing extreme financial difficulties and was unable to make payroll, supply its restaurants, or make its royalty payments to the franchisor. As a result, the bank made a loan of $235,000 to the franchisee as borrower, which loan was arranged by the trustee of the trust that owned the franchisor. The shareholders of the franchisee and their spouses personally guaranteed the loan, as did the franchisor. The loan documents also included a security agreement executed by the franchisee and the guarantors, which granted the bank a security interest in all business assets located at two of the restaurants.

Prior to the loan, the debtor did not submit any documents to the bank, to the franchisor, or to the trust with respect to the loan. Prior to granting the loan, no bank representative spoke with the debtor or inspected the collateral identified in the security agreement. In fact, the debtor had never heard of the bank and the franchisee had never done business with the bank.

Additionally, the bank held a pre-existing blanket guaranty from the trust under the terms of which the trust guaranteed all obligations of the franchisor to the bank. The debtor had never heard of the trust and had no knowledge of any liability it had to the bank.

About a year after making the loan, the bank learned from the debtor that, at the time the security agreement was executed, the vast majority of the franchisee's business assets were owned by a separate entity, not the franchisee or the debtor. Ultimately, the franchisee was unable to repay the loan and the bank pursued the guarantors, who settled for $20,000. The bank then demanded payment of the outstanding balance due on the note from the trust. The trust and the franchisor settled for a payment of $185,000 from a related entity.

After the debtor and his spouse filed for bankruptcy, the trust commenced an adversary proceeding against them, asserting that they knowingly misrepresented which entity owned the assets pledged as collateral for the loan in the security agreement and that this misrepresentation was material to the franchisor's decision to guarantee the loan. The trust sought to have the amount it paid to the bank deemed nondischargeable pursuant to § 523(a)(2)(B).

The bankruptcy court granted the trust's motion for summary judgment and the debtor and his spouse appealed. The BAP reversed and remanded with instructions to enter judgment for the debtor and his spouse, holding that the trust failed to show that it was entitled to judgment as a matter of law pursuant to the plain language of the statute as the alleged misrepresentations contained in the security agreement were made to the bank, not the trust, and the debtor and his spouse did not receive any money or property from the trust concurrent with the misrepresentations.

The Eighth Circuit affirmed, reasoning that the debtor received no money, property or services, or an extension, renewal, or refinancing of credit from the trust in connection with the misrepresentation. Additionally, the Eighth Circuit determined that the trust could not have reasonably relied on the misrepresentations as it was undisputed that the trust's liability to the bank stemmed from its own guaranty of all obligations of the franchisor, which guaranty was dated years prior to the security agreement executed by debtor.

BAP AFFIRMS THAT PERFECTION OF A SECURITY INTEREST ON 90TH DAY PRIOR TO FILING, AND SUBSEQUENT RECEIPT OF THE RELATED PAYMENT, CONSTITUTES A VOIDABLE PREFERENCE

In *Velde v. Border State Bank* (*In re HovdeBray Enterprises*) No. 12-6033 (BAP 8th Cir., December 3, 2012), the debtor executed a $350,000 promissory note in favor of the bank in connection with an operating loan on September 11, 2007. The debtor also granted the bank a security interest in essentially all of its personal property. However, the bank failed to file the financing statement with the Minnesota Secretary of State until July 13, 2010.

In mid-2010, the debtor stopped making loan payments and the bank demanded immediate payment of the $251,104.73 then outstanding on the loan. The debtor and the bank agreed that debtor would retain a liquidation service and hold a going out of business sale. The sale occurred and the gross proceeds were $426,571.79. Of that, $256,672.02 went to pay the bank note in full and another $6,403.07 went to the bank as reimbursement for the liquidation company's fees. The balance went to pay other expenses of the liquidation, including payroll and taxes.

All of the sale proceeds were deposited in the debtor's account at the bank where the bank had prior to the liquidation exercised its right of setoff on the account in the amount of $13,579.98.

An involuntary Chapter 7 petition was filed against the debtor on October 11, 2010. The trustee sought to avoid the payment of the debt to the bank as a preference. After a trial, the bankruptcy court held in favor of the trustee as to all but the $13,579.98 that was set off prior to the liquidation. Both sides appealed.

The BAP affirmed in all respects, except that it reversed as to giving the bank credit against the judgment for $1,403.07 in consulting fees it incurred, and it remanded for entry of judgment in favor of the trustee and against the bank in the amount of $244,227.11.

The BAP reasoned that because the bank perfected its security interest on the 90th day prior to the bankruptcy filing, it could not establish that it held a properly perfected lien at the outset of the filing and therefore had no "floating lien" defense pursuant to § 547(c)(5).

The BAP also rejected the bank's ordinary course of business defense pursuant to § 547(c)(2), reasoning that payment in full from a going-out-of-business sale resulting in the cessation of the business itself could not reasonably be considered within the ordinary course in any business or industry.

Likewise, the BAP rejected the bank's new value defense pursuant to § 547(c)(4), reasoning that the new value exception was not intended to apply to a situation where the creditor is, in effect, conducting a liquidation of the debtor's business so that it can be paid in full.

With regard to the setoff, the BAP reasoned that the bank received no preference by receipt of the funds it setoff prior to the liquidation because there was no dispute that the bank had a valid security interest in the debtor's account.

Finally, with respect to the reversal of $1,403.07 in consulting fees, the BAP reasoned that this amount went to the liquidator for initially assessing the situation at the bank's request to determine the best chance it had to recover, not to conduct an actual liquidation. The BAP held that the bank should be required to pay for the services it hired to analyze its own best strategy.

CLAIM MISCLASSIFICATIONS, RELIEF TO NON-DEBTOR THIRD PARTIES, AND OPTIMISTIC

PROJECTIONS DOOM CHAPTER 11 PLAN

In *In re: Scenic View Properties, LLC*, Bky. 11-60236 (Minn. Bankr., December 18, 2012), the debtor served as the developer and operator of certain real property located on a lake a few miles west of Alexandria, Minnesota. The site, which was operated as a campground, consisted of 18 acres with two seasonable rental cabins and 23 individual recreational vehicle sites for rent or purchase.

After acquiring the property, and before the bankruptcy, the debtor began surveying and platting the property into individual sites. However, the process apparently stalled, lapsed, and had to be restarted from the beginning. The debtor's plan was to sell off the individual sites and maintain rentals. Purchasers would acquire a deeded ownership of the real estate an share access to the beach, dock system, common areas, maintenance, and upkeep through association membership.

The debtor filed a plan of reorganization. An objection was filed by one of the debtor's major creditors, and the court denied confirmation. In so doing, the court determined that:

1. The plan improperly classified claims of the bank and a mechanic's lien holder in the same class despite the undisputed fact that they were competing claims that were not provided the same treatment by the plan;

2. The inclusion of competing claims in the same class rendered the vote tabulation of the unsecured class inaccurate;

3. The valuation of the bank's collateral was too low and the interest rate provided for in the plan was based on the bank's cost of funds plus a risk factor, rather than the prime rate plus a risk factor;

4. The plan improperly provided for significant relief (including eventual discharge) for a non-debtor third party guarantor;

5. The plan treatment relating to an equity interest holder provided that pre-petition equity would be surrendered and new equity would be issued to investors, but the plan failed to identify the new investors or the date on which the old equity would be surrendered; and

6. The plan was not feasible because it was contingent on overvalued lot sales, unproven rents, 20 years of ongoing services from a 68-year-old officer, and the commitment of funds from a third party that did not testify in support of the plan.

DEBTOR'S PAYMENT UNDER SETTLEMENT TO CUSTOMER WITHIN PREFERENCE PERIOD DEEMED AVOIDABLE BY TRUSTEE, BUT ATTORNEYS' FEES PAID OUT OF THE SAME PAYMENT WERE NOT

In *Ries v. Scarlett & Gucciardo, PA (In re Genmar Holdings, Inc.),* Adv. Proc. 11-4659, Bankr. No. 09-43573 (Bankr. Dist. Minn. 2013) the debtor sold customer a boat which turned out to be defective. Pursuant to the contract, the related claims were submitted to binding arbitration. Pursuant to a settlement, the debtor was to pay the customer $65,000 and the customer was to return the defective boat. The debtor was to make the $65,000 payment no sooner than 15 days after a lien had been satisfied and the title to the boat cleared and was delivered to the debtor. The payment went to the customer's attorneys' trust account. Of this amount, the attorneys kept $13,000 for legal fees and paid the customer, their client, the remaining $52,000. The transfer happened within the preference period under 11 U.S.C. §547(b).

The customer asserted two defenses under 11 U.S.C. § 547(c): (i) that the transfer was a contemporaneous exchange for new value, and (ii) that the transfer was made in the ordinary course of business. The court deemed each defense ineffective. Specifically, the court held that the 15 day delay on the payment demonstrated that the transfer was not part of a contemporaneous exchange, and that transfers made pursuant to a dispute resolution are not made in the ordinary course of business.

Although the customer had to disgorge his payment, the customer's attorneys did not have to disgorge the $13,000 they received. His attorneys were not creditors of the debtor, but did fall under "any immediate or mediate transferee of such initial transferee. 11. U.S.C. § 550(a)(2). Nevertheless, the attorneys took the payment in good faith and without knowledge of the voidability of the transfer avoided. 11. U.S.C. § 550(b)(1). Both the customer and his attorney counterclaimed for fraud in the inducement because the debtor did not disclose its insolvency during the settlement. The court dismissed these claims reasoning that the failure of a debtor to inform a creditor with whom it does business that the debtor is not solvent, by itself, does not constitute fraud or a breach of any duty owed by the debtor to such creditor.

PARTIAL EXEMPTIONS OF PERSONAL PROPERTY DO NOT EXEMPT THE PROPERTY IN ITS ENTIRETY

In *Nessan v. Lovald*, No. 12-1733 (8th Cir. 2012) a South Dakota chapter 7 debtor scheduled his motor boat, boat trailer, and truck with a $1 exemption for each item. All three items were financed by BankWest with a disability credit insurance policy. When the debtor became disabled, the insurance company commenced monthly payments pursuant to the policy. However, the insurance company stopped making payments. The debtor alleged that this was in violation of the policy and stated that he intended to sue the insurance company. On his schedules, the debtor valued his claim against the insurer at $1 and took a $1 exemption. The trustee objected and asked that all asset equity created by the insurance policy payments upon the secured loan be declared property of the estate. The bankruptcy court ordered that any amount recovered on the claim against the insurance company in excess of one dollar was property of the estate.

The debtor appealed arguing that when a debtor exempts a specific item of property, the entirety of the property is exempted, not just a partial interest in the property. The Eighth Circuit noted that South Dakota does not allow federal exemptions, and that South Dakota law only allows the head of a family aggregate personal property exemptions in the amount of $6,000. The Eighth Circuit thus determined that when the debtor claimed a $1 exemption in each item, the debtor only utilized $3 worth of the total aggregate value available to him for personal property exemptions and that, therefore, anything over and above that $3 was not exempt.

LIFE INSURANCE CONTRACTS ARE CONSTRUED ACCORDING TO THE MEANING OF THEIR TERMS

In *Kaler v. Bala* (*In re Racing Servs., Inc.*), No. 12-6025 (BAP 8th Cir. 2012), the debtor was the assignee of a life insurance policy for its principal. The related Collateral Assignment Agreement required the debtor to pay the policy's premiums and stated that the debtor would receive "upon surrender of the policy by the assignor [the principal employee], an amount of the cash surrender proceeds up to the amount of the Assignee's interest in the policy." The debtor paid $70,765.92 in premiums until it filed for bankruptcy. A year after the debtor's bankruptcy filing, the debtor and the principal were each convicted of several crimes and forfeiture judgments were entered against both the debtor and the principal. Pursuant to a court order, the life insurance policy was then liquidated and the policy's surrender value was paid to the Department of Justice. The convictions were later overturned, however, and the check paid to the Department of Justice was returned to the insurance company. The insurance company then sent a reinstatement notice to the principal, but the principal did not take any of the actions necessary to reinstate the policy.

The Chapter 7 trustee in the debtor's bankruptcy case filed an adversary complaint against the debtor's principal seeking a determination that the cash surrender value of life insurance policy was an asset of the estate. The bankruptcy court granted summary judgment in favor of trustee. On appeal, the BAP noted that, according to the language in the insurance policy, when the policy was surrendered, an assignee of the policy was entitled to the cash surrender value up to the amount of the premiums paid. Consistent with that language, the BAP found that the debtor's estate was entitled to receive the cash value proceeds of the surrendered the life insurance policy only to the extent of premiums paid and further stated that "[a]n insurance contract, like any other contract, is to be construed according to the sense or meaning of the words that are used in the contract."

GOOD FAITH IS A PREREQUISITE TO CONFIRMATION OF A CHAPTER 13 PLAN

In *In re Kremer*, Bankr. No. 12-60302 (Bankr. D. Minn. 2013), the debtor sought a modification of his Chapter 13 plan that met objections from his ex-wife and the trustee. His ex-wife alleged that debtor was delinquent in child support obligations and that the case and plan were filed in bad faith to avoid the debtor's obligations under the state family court orders and decrees. The trustee objected alleging that the debtor undervalued assets; most notably, his interest in an LLC. The debtor responded by amending his schedules to increase the value of his interest in the LLC from $0 to $21,500, to increase the plan term from 36 to 57 months, and to increase payments under the plan from $140 per month to $320 per month. The debtor also brought his child support payments current. Of the unsecured claims in the case totaling $54,005, $43,399 were related to obligations in connection with his divorce and subsequent family court proceedings.

The bankruptcy court refused to confirm the debtor's plan and dismissed the case. In so doing, the court held that "[g]ood faith is a prerequisite to confirmation of a Chapter 13 Plan" and cited the eleven factors used in the Eighth Circuit to determine if a plan has been filed in good faith. The court noted that courts should also "consider the totality of the circumstances in the light of the purposes of Chapter 13 and the general policies underlying bankruptcy relief." Upon applying these standards, the court held that "[t]he filing itself was used as a direct assault on the state family court's orders, decrees, and jurisdiction." The court thus found that the debtor lacked credibility, that the case was not filed in good faith, and that the case should be dismissed.

ONLY FINAL DECISIONS, JUDGMENTS, ORDERS, OR DECREES MAY BE APPEALED

In *Fisette v. Keller (In re Fisette)*, No. 11-3119 (8th Cir. 2012), a chapter 13 debtor's initial chapter 13 plan was denied because it proposed to strip the second and third mortgage liens on his residence. The debtor appealed. On appeal, the BAP concluded that a chapter 13 debtor may strip wholly unsecured residential mortgage liens if the value of the home is less than the amount of the senior mortgage debt. The BAP further held that: (i) Chapter 20 debtors may strip residential liens that have become unsecured claims; and (ii) as unsecured claimholders, the two junior lienholders are entitled to have their claims treated like the claims of other nonpriority unsecured claimants. Based on these conclusions, the BAP reversed the bankruptcy court's decision and remanded to allow the debtor to "amend his plan to provide for proper treatment of the junior lienholders' claims as unsecured nonpriority claims."

The trustee appealed. The Eighth Circuit dismissed the appeal, however, stating that, because the BAP had reversed and remanded, "further judicial activity" was "likely to affect the merits of the controversy." Accordingly, the Eighth Circuit held that it lacked jurisdiction under 28 U.S.C. § 158(d)(1).

DEBTOR'S CREDIBILITY OVERCOMES NUMEROUS INACCURACIES IN SCHEDULES TO OBTAIN DISCHARGE

In defeating a challenge to her discharge at trial, a debtor who convinced the bankruptcy court of her good faith, modest sophistication, and plain-spoken honesty overcame almost a dozen inaccuracies in her schedules and statement of financial affairs.

In *Borman & Schulkers, PLLP v. Clomon (In re Clomon),* Adv. No. 11-

3084 (Bankr. D. Minn. Aug. 7, 2012), the debtor filed a chapter 7 bankruptcy after a protracted and messy divorce. Prior to filing, the debtor fired her first family lawyers, who in turn sought to interfere with her ability to obtain a fresh start. Her former counsel fly-specked her petition and found rampant inaccuracies. Mostly, errors or omissions in the $3,000 - $5,000 range, undisclosed transactions related to her court-ordered divorce decree, and assets in accounts that were exempted or not even owned by the debtor.

The court found none of the errors or omissions demonstrative of a fraudulent scheme to abuse the bankruptcy process. Rather, after taking testimony the court found the debtor "honest and straightforward, and humble and befuddled." The court held that, while multiple errors and inaccuracies can establish a reckless disregard for the truth in "nine out of ten cases" and result in denial of discharge under various provisions of section 727, all can be overcome in the "exceptional case that hinges on the Court's certain finding of credibility in the debtor's favor, with respect to intent."

For those routinely active in 727 litigation, *Clomon* provides an excellent resource of case law citations for Section 727(a)(3), (a)(4) and (a)(5) and should be stored for future briefing needs.

COURT MUST CONSIDER THE NUMBER AND AMOUNT OF UNPAID CLAIMS IN INVOLUNTARY PROCEEDINGS

In an involuntary proceeding, the court must consider the number and the amount of unpaid claims against the debtor in its analysis of whether the debtor is generally paying its debts as they become due.

In *Murrin v. Hanson (In re Murrin)*, Case. No. 12-987 (D. Minn. 2009), the debtor invested in a failed real estate company. In seeking to recoup his loss, he engaged in overaggressive litigation against employees of the failed company. After defeating his claims the employees obtained sanctions against the debtor. After encountering obstructions in collecting the awards, the sanction holders filed an involuntary petition. The bankruptcy court granted the petition, but on appeal the district court remanded.

Section 303 of the Bankruptcy Code governs the requirements for an involuntary case. Generally, the petitioners must number three parties holding claims that are neither contingent nor subject to a bona fide dispute. The district court affirmed that the sanction holders were distinct creditors to reach the requisite number of three petitioning creditors.

Courts must further find that the debtor is not paying such undisputed debts as they come due. Courts generally consider four factors when determining whether or not the debtor is paying his debts as they come due: (1) the number of unpaid claims; (2) the amount of the claims; (3) the materiality of nonpayment; and (4) the overall conduct of the debtor in its financial affairs. While the test is totality of the circumstances, the district court found that most courts leaned heavily on consideration of factors (1) and (2). The bankruptcy court did not consider these factors, and the district court therefore reversed and remanded to allow for their consideration.

The district court emphasized that involuntary bankruptcy provides a remedy for more than just the petitioning creditors, and that the court must consider whether bankruptcy will benefit non-petitioning creditors as well. By focusing only on the debtor's behavior with respect to the claims of the petitioning creditors, the involuntary proceeding risked taking the form of a debt collection procedure for a specific group of creditors rather than a remedy for all of the debtor's creditors. As stated by the court, "it is certainly possible that involuntary bankruptcy is appropriate where the only unpaid debts are those of the petitioning creditors. But courts that have reached such a conclusion have generally done so when the unpaid debt or debts constitute the majority of the overall debt."

UPPER MIDDLE-CLASS INCOME DEBTORS DENIED CHAPTER 7 RELIEF

Owing $382,251.23 in credit card debt, $69,050 in student loan debt, and losing a house in foreclosure is no guarantee of successfully navigating a Chapter 7 if the debtors generate a low, six-figure income yielding approximately $3,000 in disposable monthly income, and further take steps to manipulate the disclosure of their income.

In *In re Rieck*, Bky. No. 11-37742, (Bankr. D. Minn., Oct. 19, 2012), the debtors failed to disclose a year-end bonus due shortly after the bankruptcy filing for the purpose of avoiding the presumption of abuse based on the income test. The debtors lived in a Woodbury residence valued somewhere between $300,000 and $400,000. They drove a 2009 Honda Accord and a 2007 Mazda RX8, with monthly loan payments totaling more than $1,000. While this may look in many cases like a common upper-middle class balance sheet, the court found that the debtors could certainly reduce their spending, and that was apparent "that the debtors in this case are not needy." In light of these facts, the United States Trustee successfully moved to dismiss or convert the debtor's bankruptcy case as an abusive filing.

The court identified a number of factors under Section 707(b)(3)(B) to consider in determining whether abuse exists: whether the debtor has a stable source of income, whether the debtor is eligible for Chapter 13, whether state remedies would ease the debtor's financial predicament, the degree of relief obtainable through private negotiations, and whether expenses can be reduced without depriving the debtor of necessities.

The court found that the debtors' failure to make any attempt to pay their unsecured creditors prior to bankruptcy, and their unwillingness to convert to Chapter 11, combined with their income which they failed to disclose candidly, demonstrated that their case was merely "an unfair attempt to manipulate the Bankruptcy Code." While the debtors were not eligible to file a chapter 13, the court found that fact non-dispositive to the debtors' entitlement to chapter 7 relief. As a result, the court ordered their case dismissed or, alternatively, converted to a Chapter 11 on the debtors' request.

STATE COURT JUDGMENT ON TORTIOUS INTERFERENCE ESTABLISHES WILLFUL AND MALICOUS CONDUCT FOR EXCEPTING DEBT UNDER SECTION 523(A)(6)

A state court jury verdict finding that the debtor tortiously interfered with prospective business relations "without justification" collaterally estopped the debtor from contesting that his acts were "willful" and "malicious," and the bankruptcy court confirmed that the tortious interference claim was non-dischargeable.

In *PLM Lake & Management Corp. v. Duy, Sr. (In re Duy, Sr.),* Adv. No. 11-5008 (Bankr. D. Minn., Dec. 28, 2012), the debtor sold his aquatic weed control business to a third party. The asset purchase agreement imposed confidentiality and non-compete duties on the debtor, as seller. Shortly after the sale, the debtor's son opened a competing business, obtained a full customer list of his father's business, and began soliciting customers away from the buyers. The buyers discontinued making payments under the asset purchase agreement. A lawsuit resulted, and a state court jury found the debtor breached the asset purchase agreement and intentionally interfered with the contracts, economic advantages, and business prospects of the buyer. The jury awarded damages in the amount of $352,815 and the state court awarded costs and attorneys' fees exceeding $500,000.

The court held the entire award non-dischargeable under Section 523(a)(6) which excepts from discharge a debt based on a "willful and malicious injury" inflicted by the debtor. The jury verdict and other state court findings of intentional interference adequately established the "willful" and "malicious" elements. The jury found "interference," which the court defined as the "deliberate or intentional meddling with another party's exercise of its own rights." The definition was deemed consistent with the Bankruptcy Code's use of "willful" which courts have found to mean "intentional or deliberate…headstrong and knowing," or "deliberate in invading right of the claimant that the debtor knew were protected under law."

The jury's finding that the debtor acted "without justification" demonstrated his malice. The Eighth Circuit has defined malice as "conduct…targeted at the creditor…at least in the sense that the conduct is certain to cause financial harm." *In re Long*, 774 F.2d 875, 880 (8th Cir. 1985). The court relied on a jury instruction which the jury answered affirmatively to find that the debtor "had no proper reason to use or disclose the information to support his son's entry into direct competition [with the buyer]." This finding demonstrated that the debtor had specifically targeted the buyer for harm because the buyer had a relationship with the parties that the debtor and his son pursued. The actions in direct competition with the buyer "made the harm near certain to occur." These findings adequately established the element of malice for 523(a)(6).

Last, the court held the cost and attorney's fee awards were non-dischargeable. Ancillary debts such as treble damages or attorney's fees are non-dischargeable depending on the nature of the underlying debt. While the state court based its attorney's fees award on a fee award provision in the asset purchase agreement, the bankruptcy court found that the fee award could assume the same non-dischargeable character since the conduct leading to the breach of the agreement was the same conduct that led to tort liability. The court concluded that the debtor's conduct "was anything but a simple 'breach of contract'…It was an expropriation of property in itself, a necessary precursor to the tortious conduct that gave rise to the main liability."

TAX ATTRIBUTES OF PROPERTY RELEVANT IN SECTION 506 VALUATION PROCEEDING

A court must factor the availability of future tax credits that run with the land when valuing real estate in a Chapter 11 bankruptcy. In *U.S. Bank National Association v. Lewis and Clark Apartments, LP*, 12-6023 (8th Cir. BAP, Oct. 11, 2012), the owner of an apartment complex that qualified for the federal and state Low Income Housing Tax Credit through 2018 filed a Chapter 11 bankruptcy and sought to cram down the secured lender. The credit and the associated covenants requiring a longer period of low income leasing were deemed to run with the land and encumber any purchaser's use of the property.

In the 506(a) proceeding in connection with the lender's motion for relief from stay as well as an upcoming confirmation hearing, the debtor valued the property at approximately $3.4 million but did not factor the credits. The lender's appraisal included the credits and valued the property at $5.1 million. The bankruptcy court did not factor the credits into the valuation. The BAP stated that the test of valuation was what a willing buyer would pay for the property, and that the credits would be a factor considered by the buyer. The court also found that excluding consideration of the creditors would be unfair since the leasing restrictions would reduce the value of the property under an income capitalization approach. As stated by the BAP, "in the same way that the caps and other restrictions on the use of the property may affect its value negatively, the tax credits available to the owners as a result affect its value positively." The BAP therefore remanded for further findings.

The BAP considered the appeal though the order to value was not final as the bankruptcy court did not require valuation to grant stay relief and had not ruled on plan confirmation. Nonetheless, the bankruptcy court's decision not to factor the tax attributes in the value of the property conflicted with a decision of a Sixth Circuit BAP decision. The issue presented on appeal involved a controlling and novel question of law, for which there was a difference of opinion regarding the bankruptcy court's decision. The BAP thus considered the matter as proper for an interlocutory appeal.

DEBTOR'S INTEREST IN PROFIT SHARING PLAN EXEMPT UNDER MINNESOTA LAW

In *Foellmi v. Ries (In re Foellmi)*, No. 12-6003 (B.A.P. 8th Cir. July 31, 2012) (Venters, J), the debtor appealed from an order of the bankruptcy court denying her claim of exemption for an asset described as "CSI Kwik Trip Profit Sharing," which consisted of shares distributed to the debtor by her employer through an employee benefit plan. The debtor originally scheduled the asset as exempt under 11 U.S.C. § 522(d)(10)(E). The trustee objected, and the debtor amended her schedules to claim the asset exempt under 11 U.S.C. § 522(d)(5). The trustee again objected, and the debtor then amended her schedules to claim the asset exempt under Minn. Stat. § 550.37, Subd. 24. The trustee objected a third time, and the bankruptcy court sustained the objection on the basis that the asset did not meet the requirements of Minn. Stat. § 550.37, Subd. 24, because (i) the plan pursuant to which the shares were distributed was not a "retirement or disability plan," (ii) the statute does not allow for the exemption of partnership interests, (iii) the debtor's interest had terminated, and (iv) the distributions received by the debtor were not "rights to payment on account of illness, disability, death, age or length of service."

The debtor appealed to the BAP, which reviewed the bankruptcy court decision *de novo*. The BAP concluded that the employee benefit plan was similar to those plans listed under Minn. Stat. § 550.37, Subd. 24, and that the debtor's right to payments under the plan was on account of the length of her service to her employer. The BAP therefore held that the debtor's interests in the shares were entitled to exemption under Minn. Stat. § 550.37, Subd. 24 up to the statutory limit. The BAP reversed the bankruptcy court's decision and remanded to the bankruptcy court to determine whether the amounts over the statutory limit were reasonably necessary for the debtor's support.

WHERE SAME TRANSACTION TEST IS MET, RECOUPMENT ANALYSIS DOES NOT REQUIRE SEPARATE BALANCING OF EQUITIES

In *Terry v. Standard Ins. Co. (In re Terry)*, No. 11-2582 (8th Cir. Aug. 3, 2012) (Benton, J), the debtor received a lump sum award of retroactive Social Security disability benefits. His disability insurer, which was contractually entitled to any retroactive benefits paid to the debtor, withdrew the funds from the debtor's account. The debtor then filed a chapter 7 petition. The trustee made a preference demand to the insurer for return of the funds it had withdrawn. The insurer returned the funds, but then began reducing the debtor's monthly benefit payment to recover the funds it had paid to the trustee. The debtor later filed an adversary complaint against the trustee, seeking a determination that the recovered funds were exempt and declaratory relief that the insurer was not entitled to reduce his monthly benefits on account of the recovered funds.

The bankruptcy court agreed with the trustee that the funds were not exempt because they had been voluntarily transferred by the debtor to the insurer, and also found that the insurer was not entitled to recoup the funds from the debtor by reducing its monthly benefit payments. The insurer appealed to the BAP, which reversed and remanded for the bankruptcy court to determine whether recoupment was equitable under the circumstances. The bankruptcy court again ruled that the insurer was not entitled to recoup the funds. The insurer again appealed, and its appeal reached the Eighth Circuit. The Eighth Circuit applied the "same transaction" test, stating, "Recoupment allows a defendant to deduct its claim from the amount the plaintiff could otherwise recover *if* the claim arises out of the same transaction or subject matter on which the plaintiff sued." No separate "balancing of the equities" test is required where the same transaction test has been met. The Eighth Circuit reversed the bankruptcy court and BAP judgments, and remanded to the bankruptcy court for proceedings consistent with its opinion.

DISALLOWED LATE FILED CLAIM DOES NOT PROVIDE INDEPENDENT BASIS FOR INVALIDATING LIEN UNDER SECTION 506(d)

In *Shelton v. CitiMortgage, Inc. (In re Shelton)*, No. 12-6040 (B.A.P. 8th Cir. Sept. 24, 2012) (Venters, J.), the debtors filed an adversary complaint seeking to avoid CitiMortgage's lien on their residence pursuant to 11 U.S.C. § 506(d) on the basis that CitiMortgage's proof of claim had been disallowed for being untimely filed. CitiMortgage filed a motion to dismiss, which the bankruptcy court granted. The debtors appealed to the BAP.

The BAP acknowledged that the plain language of the statute supported the debtors' argument, but observed that such a reading would lead to an absurd result in allowing a creditor that filed no claim to "fare better than a creditor with a late-filed claim." The BAP also examined the decision *In re Be-Mac Transport*, 83 F.3d 1020 (8th Cir. 1996), in which the Eighth Circuit had held that a creditor's untimely proof of claim amendment was not sufficient basis on which to invalidate the lien securing the claim. Based on the *In re Be-Mac Transport* decision, principles of statutory construction, and the statute's legislative history, the BAP concluded that CitiMortgage's lien could not be avoided under § 506(d) solely on the basis that its claim had been disallowed as untimely. The BAP therefore affirmed the bankruptcy court decision.

EVIDENCE OF UNUSUAL COLLECTION ACTIVITIES AND INSUFFICIENT EVIDENCE OF INDUSTRY TERMS RESULT IN PREFERENCE JUDGMENT FOR TRUSTEE

In *Ries v. Trend Marine Prods. Ltd. (In re Genmar Holdings, Inc.)*, Bk. Nos. 09-43537 and 09-43546, Adv. Nos. 11-4704 and 11-47-5 (Bankr. D. Minn. Nov. 15, 2012) (O'Brien, J.), the trustee sued the defendant under 11 U.S.C. § 547 to recover prepetition payments made by the debtor to the defendant. The parties agreed that the payments were preferences, but the defendant raised affirmative defenses.

First, the defendant argued that some of the payments were made in the ordinary course of business or on ordinary business terms and therefore not avoidable pursuant to 11 U.S.C. § 547(c)(2)(A) and (B). The bankruptcy court found that although there was only a four day difference in average days to pay between invoice and payment in the two years prior to the bankruptcy and the preference period, the court noted that during the preference period the defendant had engaged in unusual collection efforts. Therefore, the bankruptcy court found that the § 547(c)(2)(A) defense did not apply. The bankruptcy court then found that the § 547(c)(2)(B) defense did not apply because the defendant had not presented evidence regarding the range of practices in the relevant industry, let alone identified the relevant industry. The affidavit of the defendant's head of finance was insufficient to establish the defense.

Second, the defendant argued that the remainder of the payments constituted subsequent transfers of new value and therefore were not avoidable as preferential pursuant to 11 U.S.C. § 547(c)(4). The bankruptcy court "summarily rejected" that argument without analysis and therefore ruled in favor of the trustee on the entire demand.

DISTRICT COURT DENIES RECEIVER STANDING UNDER THE FEDERAL DEBT COLLECTION PROCEDURE ACT

In *Kelley v. College of St. Benedict*, 12-822 (RHK/LIB) (D. Minn. Oct. 26, 2012) (J. Kyle), the United States Bankruptcy Court denied a court-appointed receiver's attempt to recover $2 million in allegedly fraudulent transfers.

In January 2003, noted Ponzi schemer Thomas J. Petters pledged $3 million to the defendant in return for the defendant's agreeing to name an auditorium after Petters' parents. Between 2003 and 2005, Petters and the Thomas J. Petters Family Foundation transferred $2 Million of the pledged $3 million to the Defendant. However, prior to fulfilling his obligation, Petters was arrested and indicted in connection with orchestrating the Ponzi scheme. After the indictment, a receiver was appointed to manage and administer the assets of the Petters corporate entities, which included the Foundation, and the receiver was given authority to pursue causes of action held by the various entities. In addition, the receiver entered into a Coordination Agreement with the United States designed to prevent the receiver and the United States from interfering with each other's respective efforts relating to the Petters scheme. The receiver then instituted an action against the defendant (i.e., the recipient of the $3 million pledge) seeking to recover the transfers under the under the Federal Debt Collection Procedure Act ("FDCPA"), the Minnesota Fraudulent Transfer Act ("MFTA"), and under the theory of unjust enrichment.

As to the causes of action under the FDCPA, the defendant argued, and the court agreed, that the receiver did not have standing because: (i) court-appointed receivers may only bring actions on behalf of the entities in receivership and (ii) only the United States may bring actions under the FDCPA. Therefore, the receiver could only bring the current action on behalf of the United States. However, as the United States was not in receivership, the receiver lacked standing. The court further dismissed the claims under the MFTA, as they were only relevant to the defendant's defenses to the FDCPA claims.

The court also dismissed the receiver's unjust enrichment claim. The court noted that where an adequate legal or statutory remedy exists, a claim for unjust enrichment will not lie. In the current instance, the MFTA provided the receiver with an adequate legal remedy. Therefore, the receiver's unjust enrichment claim was inappropriate and was dismissed

EIGHTH CIRCUIT UPHOLDS REQUIREMENT THAT AMENDMENTS TO DEBTOR'S SCHEDULES REQUIRE BANKRUPTCY COURT APPROVAL

In the case of *Hecker v. Seaver (In re Hecker)*, 11-3523 (8th Cir. Jan. 11, 2013) (J. Loken), the Eighth Circuit Court of Appeals upheld the requirement that a debtor seeking to amend its bankruptcy schedules must seek approval from the bankruptcy court to do so.

In September 2005, the debtor and two of its affiliates entered into a sales-commission agreement with a third party whereby the latter received certain vehicle fleet-leasing assets in exchange for $20 million plus a series of incentive payments. In 2009, the debtor filed for chapter 7 protection and listed the commission agreement as non-exempt personal property with an estimated value of $6 million. Subsequently, the debtor amended its Schedule C twice, but at no time claimed the commissions agreement to be exempt property. The Chapter 7 trustee and two creditors asserted claims against the non-debtor party to the commission agreement for outstanding commissions owed. This ultimately resulted in a settlement pursuant to which the non-debtor party agreed to pay $2.07 million to the debtor's bankruptcy estate and $2.03 million to the two complaining creditors. The trustee filed a motion to approve the settlement and the debtor objected claiming for the first time that the commission agreement was an employment agreement, which made any payments under the agreement exempt property.

The bankruptcy court approved the settlement and denied the debtor's objection, as it never filed a motion to amend its Schedule C. In doing so, the bankruptcy court also denied the debtor's oral request for a continuance so that it could file such motion to amend. The district court affirmed the bankruptcy court's decision and an appeal to the Eighth Circuit followed.

The primary issue before the Eighth Circuit was whether the bankruptcy court erred in denying the debtor's oral request for a continuance. The debtor did not claim that the commission agreement was exempt until the trustee sought court approval of the settlement. In addition, the debtor continuously represented that he was self-employed and had no prospective wages or salary. The parties to the settlement resolved multiple disputes regarding the commission agreement in reliance on these representations by the debtor. Although Federal Rule of Bankruptcy Procedure 1009(a) allows a debtor to amend its schedules up to and until a bankruptcy case is closed, the debtor never requested approval from the bankruptcy court. Therefore, the Eighth Circuit held, the decision to allow such an amendment was never before the court, and the debtor's lack of due-diligence was of no moment. Based on these factors, the Eighth Circuit held that the bankruptcy court did not err in denying the debtor's last-minute oral request for a continuance.

EIGHTH CIRCUIT FINDS THAT LICENSE AND TRADEMARK AGREEMENT CONSTITUTES AN EXECUTORY CONTRACT

In the case of *Lewis Bros. Bakeries Inc. and Chicago Baking Co. v. Interstate Brands Corp. (In re Interstate Bakeries Corp.)*, 11-1850 (8th Cir. Aug. 30, 2012) (J. Bye), the Eighth Circuit Court of Appeals analyzed executory contract principles in light of a license agreement and determined that material obligations remained unperformed on both sides of the agreement.

In 1995, the debtor acquired Continental Baking Company. A subsidiary of the debtor later entered into an agreement granting third parties an exclusive license to use certain brands and trademarks so long as those third parties maintained the character and quality of goods sold under the trademarks. The third parties were also obligated to maintain and defend the trademarks as well as perform other infringement-related duties.

In September 2004, the debtor filed for Chapter 11 protection and listed the trademark agreement as an executory contract. The third parties disagreed with this characterization and filed an adversary proceeding seeking either (i) a declaratory judgment that the agreement was not an executory contract, or (ii) a determination that the debtor was estopped from claiming that the agreement was executory because the debtor treated the agreement as a full sale of licenses and trademarks. The United States Bankruptcy Court for the Western District of Missouri found that the Agreement was indeed executory, as material obligations remained unperformed on both sides. The United States District Court for the Western District of Missouri later affirmed, and an appeal to the Eighth Circuit followed.

The Eighth Circuit applied the "Countryman test," stating that a contract is executory if the obligations of both parties to the agreement are so far underperformed that a failure by either party to complete performance would constitute a material breach relieving the other side from performance. The trademark agreement expressly stated that the third parties' failure to maintain the character and quality of the goods would constitute a material breach, and that such obligation was ongoing. Further, the third parties' obligation to maintain and defend the trademarks, and to satisfy other infringement-related obligations, were also ongoing and outstanding. Based on these factors, the court ultimately found that remaining obligations on both sides of the trademark agreement were of a material nature, thus rendering the trademark agreement executory.

TRIGGERING A DEBTOR'S BURDEN OF PRODUCTION REQUIRES MORE THAN ALLEGATIONS IN A COMPLAINT FOLLOWED BY A DENIAL

In the case of *McDermott v. Swanson (In re Swanson)*, 12-6028 (8th Cir. B.A.P. Aug. 17, 2012) (J. Venters), the Bankruptcy Appellate Panel for the Eighth Circuit Court of Appeals reversed a decision by the United States Bankruptcy Court for the District of Minnesota denying a debtor's discharge under 11 U.S.C. §§ 723(a)(3) and (a)(5).

The debtor filed for Chapter 7 protection on July 27, 2012. Not long after the petition, the Chapter 7 trustee filed a complaint seeking denial of discharge under 11 U.S.C. §§ 727(a)(3) and (a)(5) based on the debtor's alleged failure to maintain adequate financial records and to explain a loss of assets. In its answer, the debtor admitted the following: (i) it had profited from a Ponzi sheme; (ii) after the Chapter 7 petition, the trustee requested documents regarding the disposition of the profits received from the Ponzi scheme; and (iii) the debtor did not produce the requested documents. The debtor further provided financial documents showing receipt of a $15,000 profit and denied any failure to keep adequate records. The trustee moved for judgment on the pleadings under Federal Rule of Bankruptcy Procedure 8012 and Federal Rule of Civil procedure 12(c). The bankruptcy court granted the trustee's motion and an appeal followed.

The BAP reversed the bankruptcy court's decision and found that the pleadings contained insufficient facts to deny the debtor's discharge. In arriving at this conclusion, the BAP noted that a complaining party bears the burden of proving that a denial of discharge is warranted under §§ 727(a)(3) and (a)(5). Once the complainant has proven the requisite elements, the burden of production then shifts to the debtor.

The BAP held that the initial pleadings failed to establish that the debtor's records were insufficient, or that the debtor failed to account for lost assets. The trustee merely provided allegations and the debtor responded with a denial, which, taken together, did not trigger the debtor's burden of production. Stated another way, because the debtor's burden of production would have been triggered only after the trustee affirmatively established the elements for a denial of discharge, and the trustee never did so, the debtor was under no production obligation in the current case.

JUDGMENT BASED ON UNAUTHORIZED USE OF TRADE SECRETS NON-DISCHARGEABLE UNDER §523(A)(6)

In *In re Kevin B. Koch v. SKF USA, Inc.*, No. 12-01606, (D. Minn. 2012) (J. Montgomery), the district court affirmed the bankruptcy court's finding that a judgment based upon the debtor's unauthorized use of trade secrets was non-dischargeable. Under Section 523(a)(6) of the Bankruptcy Code, a debt is non-dischargeable if it results from "a willful and malicious injury." In its discussion, the court explained that a legal injury is "willful" if it is "deliberate or intentional," and it is "malicious" if the "conduct is certain or almost certain to cause financial harm." In this case, the district court held the requirements of Section 523(a)(6) were satisfied, and a prepetition debt was non-dischargeable, where a judgment was obtained after the debtor formed a company that directly competed against the appellee using its own trade secrets. In affirming the bankruptcy court's order, the district court reasoned that the debtor had "willfully" (and admittedly) taken and used thousands of files containing client information and related proprietary data, and debtor knew such conduct was "certain to harm" the appellee when it lost its clients as a result of debtor's unauthorized use of such information. Notably, the district court also held that an award of attorneys' fees related to the underlying judgment was non-dischargeable under Section 523(a)(6), stating that the Bankruptcy Code does not distinguish between debts that are compensatory versus punitive in nature.

FACTS JUSTIFIED WAIVER OF PATIENT CARE OMBUDSMAN REQUIREMENT

In *In re: Flagship Franchises of Minnesota, LLC et al.,* Bankr. No. 12-36898 (Bankr. D. Minn. 2013) (J. Sanberg), the bankruptcy court held that appointment of an ombudsman was not necessary under the specific facts of the case at issue. Whenever a debtor is a health care business, Section 333(a)(1) of the Bankruptcy Code requires the U.S. Trustee to appoint a patient care ombudsman no later than 30 days after the petition date. The purpose of an ombudsman is to monitor the quality of patient care and to represent the interests of the debtor's patients. Where, as here, the debtor has moved for a waiver of this requirement, the court applies a nine factor test to the facts of each case to determine whether the welfare of debtor's patients will be adequately protected in the absence of an official ombudsman. In reaching its decision, the bankruptcy court noted, among other things, that the debtor had a long history of high quality care, alternative internal and external regulatory safeguards were in effect to protect patients, and the cost of the ombudsman would be a substantial burden to the estate.