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Trademark License Agreement Executed In Context Of A Business Sale Is Not Executory For Purposes Of Section 365 Of The Code

In *Lewis Brothers Bakeries Inc., et al. v. Interstate Brands Corp.*, No. 11-1850, the Eighth Circuit held that a trademark licensing agreement executed in connection with the sale of a business was not subject to rejection under Section 365. In so holding, the Eighth circuit emphasized that when two or more contracts are executed concurrently in a single transaction, a determination that one of the contracts is executory must take into consideration the effect of the transaction as a whole. In this case, the debtor sold its entire bread business in the Chicago metro area and three other markets. In addition to selling all relevant facilities, equipment, and customer lists in these territories, the debtor entered into a perpetual, royalty-free licensing agreement for the trademarks associated with its bread business. The Eight Circuit examined all of the contracts related to such sale as a single contract, and determined that the sale transaction had been "substantially performed" by both parties. On this basis, the Eighth Circuit reversed the District Court's prior decision that the licensing agreement was executory because both parties had on-going duties to maintain quality standards, defend the trademarks from infringement, and comply with notice requirements.

Failure To Timely Assume A Lease Prior To A 363 Sale Precludes Transfer Of Debtor's Lease Rights To Asset Purchaser

In *Agri Star Meat & Poultry, LLC; SHF Industries, LLC v. Nevel Properties Corp.*, No. 13-1161, the Eighth Circuit affirmed a Bankruptcy Court decision that a well lease was "deemed rejected" where the debtor did not timely assume such lease prior to selling its assets in a 363 sale.

Under Section 365(d)(4) of the Bankruptcy Code, if the debtor is the lessee under a lease for non-residential real property, such lease shall be deemed rejected if the Trustee does not assume or reject it within 120 days of entry of an order for relief, or confirmation of a plan, whichever occurs sooner. Additionally, Section 365(b) requires a debtor to cure any existing defaults under the lease in order to validly assume it. In the *Agri Star* case, the bankruptcy court found that a "deemed rejection" had occurred where the debtor failed to assume or reject the well lease within the 120-day statutory period. The parties also conceded that the debtor did not cure the lease-related defaults. Because the deemed rejection pre-dated the 363 sale, the Eighth Circuit affirmed the bankruptcy court's decision that the buyer of debtor's assets had acquired no rights under the well lease in the 363 sale.

Derivative Standing To Bring Claim Where Trustee Is Unable Or Unwilling To Do So Allowed Only Under Limited Circumstances

In *Larson v. Foster, et al.* (Case No. 14-6007, 8th Cir. BAP) the Eighth Circuit BAP did not grant a Creditor derivative standing to bring a claim against the Debtor where the Trustee had not asserted the claim. Prior to the bankruptcy filing the Creditor purchased Debtor's business, with obligations outstanding on both sides at the time of

the bankruptcy filing which were disputed by the parties. Debtor had assigned payments due from the Creditor to a third party, however Debtor did not include any information relating to Creditor, the sale of the business to Creditor or the assignment to the third party in the schedules to her bankruptcy petition. The Creditor asked the Trustee to pursue a fraudulent transfer claim under 11 U.S.C. § 548 and was told further investigation would be required. The Creditor brought a fraudulent transfer action claiming derivative standing.

The BAP stated that "[a]s a general proposition it is well settled that [fraudulent] transfers may only be avoided by a trustee," however the "Eighth Circuit permits derivative standing to bring an avoidance action when it can be shown that the trustee is unable or unwilling to do so." "The party seeking such derivative standing bears the burden of proof on four separate factors: (1)the trustee was petitioned to bring the claim and refused; (2) the claim is colorable; (3) permission was sought from the bankruptcy court to initiate the adversary proceeding and (4) the trustee unjustifiably refused to pursue the claim." The BAP focused on the first and fourth factors. Creditor believed that because the Trustee might not complete his investigation before the Debtor's debts would be discharged this meant he was declining to pursue the fraudulent transfer claim. The BAP noted that 11 U.S.C. § 546(a)(1) sets forth the time in which the Trustee must assert a fraudulent transfer claim and that adequate time remained and that there was "no evidence that the Trustee refused to undertake avoidance of the transfer, rather, he merely responded that he would need more information."

In examining the final factor, the BAP noted that a "trustee's refusal to bring suit focuses on whether a clear benefit to the estate can be identified or whether only insignificant benefits would be realized. In making this comparison a court may consider the probability of success in litigation, potential financial recovery, expenses which could be incurred and delay in case administration." While the BAP acknowledged that the Creditor identified a benefit to the Estate from his willingness to fund the fraudulent transfer litigation, the BAP noted that the Creditor's claims were unliquidated and disputed. As a result allowing derivative standing would allow Creditor to litigate claims underlying his purchase of Debtor's business which would be of primary benefit to Creditor, not the Estate. Acknowledging that derivative standing is the exception, the BAP ruled that allowing it under such circumstances would not be appropriate.

The BAP also noted that the Eighth Circuit allows for derivative standing where a trustee consents or does not formally oppose a creditor's suit. However, the Trustee did not consent to derivative standing in this case. The BAP further noted that even if the Trustee had consented giving the Creditor derivative standing, "a bankruptcy court must also find that the suit is necessary, beneficial and in the best interests of the estate." The BAP upheld the Bankruptcy Court's decision that allowing Creditor derivative standing was not necessary or beneficial to the resolution of the Debtor's bankruptcy case.

Minnesota UFTA Applies To Transfer Made Between Spouses Pursuant To A Marital Termination Agreement

In *Citizens State Bank Norwood Young Am.*

v. Brown, the debtor guaranteed certain commercial loans to the creditor. When the underlying borrowers defaulted, the debtor failed to satisfy his obligations under the personal guarantee. The creditor obtained a default judgment against the debtor. During the pendency of that lawsuit, the debtor petitioned to dissolve his 23-year marriage and, later in that proceeding, the debtor and his wife executed a marital termination agreement. The district court found that agreement to be "fair and reasonable," and incorporated its terms into a dissolution judgment and decree of divorce. Pursuant to the dissolution judgment and decree, the debtor transferred certain valuable assets to his wife, and retained certain liabilities and limited assets. The debtor and his ex-wife continued to live together. The creditor was unable to collect from the debtor and brought this action under the Minnesota UFTA alleging the transfers were made with the intent to defraud the creditor. The district court specifically found a number of badges of fraud and held that the transfers were voidable under the MUFTA. The debtor and his ex-wife appealed, and the Minnesota Supreme Court granted review to address the threshold question of whether the MUFTA applies to transfers made pursuant to an uncontested marital dissolution decree.

The court explained that the purpose of MUFTA is "to prevent debtors from placing property that is otherwise available for the payment of their debts out of the reach of their creditors." Under the MUFTA, a transfer is fraudulent "if the debtor made the transfer . . . with the actual intent to hinder, delay, or defraud any creditor." The term "transfer" is defined by the statute as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset." Because a transfer pursuant to an uncontested marital dissolution decree is a mode of "disposing of or parting with" assets, the court held it falls squarely within the statutory definition of "transfer." This reading is consistent with other states' interpretation of the UFTA, which is significant because "uniform laws are interpreted to effect their general purpose to make uniform the laws of those states that enact them," and accordingly, the court gives great weight to other states' interpretations of a uniform law.

The court then examined the badges of fraud, finding six of the eleven badges were present. A single badge of fraud may, but not necessarily, prove fraudulent intent. "The presence of several badges of fraud, however, creates an inference of fraud that requires clear evidence of a legitimate purpose to rebut." First, the court considered whether the transfers were to an "insider." While at the time of the transfers, the debtor and his ex-wife were no longer spouses, that would not necessarily preclude a finding that his ex-wife was an insider. The definition of "'[i]nsider' includes . . . a relative." However, the court explained that the term "includes" indicates the definition is nonexclusive. Since the debtor and his ex-wife were married for 23 years and continued to live together post-divorce, a continued close relationship was demonstrated, sufficient for a finding that his ex-wife was still an "insider."

Next, the court considered whether the debtor transferred substantially all of his assets to his ex-wife. The court examined the value of the transfers and found that

the value of the debtor's non-exempt assets before the dissolution exceeded $1.5 million. However, post-dissolution, the debtor's remaining non-exempt assets consisted of a $3,000 checking account and corporate stock valued at $80,000. Clearly, the debtor transferred substantially all of his assets in the dissolution. The court further found that the debtor did not receive reasonably equivalent value in exchange for the assets transferred to his ex-wife because the only property she transferred to him was the home (the majority of which was exempt) and he assumed sole responsibility for their joint debt obligation which vastly exceeded the non-exempt equity in the property transferred to him. Accordingly, this badge of fraud was also present. The record also supported a finding that the debtor was insolvent or became insolvent shortly after the transfer because following the dissolution, the debtor had a negative net worth – another badge of fraud under the MUFTA.

The court continued to reason that there was likewise no dispute that the debtor had been sued or threatened with a lawsuit when the dissolution decree was entered. The creditor sued the debtor and approximately nine months later, the debtor and his ex-wife signed the marital termination agreement. The dissolution judgment and decree were entered shortly thereafter. In considering whether the transfers occurred shortly before or shortly after a substantial debt was incurred, the court accepted that the debt was incurred when the default judgment was entered against the debtor. Then, less than four months later, the transfers occurred. While the debtor and his ex-wife argued they had no control over when the dissolution decree was entered, the court found this argument unavailing because the debtor and his ex-wife had already set the transfers in motion when they petitioned to dissolve their marriage. When the debtor initiated the transfers, the court reasoned that he had already been sued and "reasonably would have anticipated that he would soon incur a substantial debt." Thus, the court concluded that this badge of fraud was established.

The court held that the MUFTA applies to uncontested marital dissolution decrees and in this case, the transfers at issue exhibited several badges of fraud which provided "conclusive proof of fraudulent intent." However, the court specifically noted that its decision does not reach the broader question of whether the MUFTA would apply to contested marital dissolution decrees.

Indeed, in his concurrence, Justice Anderson cautioned that often, "not much is required to move an 'uncontested' divorce proceeding into the adversarial category" and likewise, "many contested, disputed, or adversarial marriage dissolutions, with varying degrees of intensity, eventually become 'stipulated' for purposes of dissolving the marriage." Accordingly, the concurrence stresses that a party's intent to defraud creditors through a marital dissolution transfer will often be a question of fact and the courts should be particularly watchful of summary judgment motions in spousal transfer cases where fraud is alleged.

Violation Of A Statute Is Evidence Of Malicious Intent For The Puposes Of Non-Dischargeability Under 11 U.S.C. § 523(a)(6)

In *Sailor Music, et al. v. Walker* (Case No.

14-6012, 8th Cir. BAP) the Eighth Circuit BAP did not allow the discharge of certain debt under 11 U.S.C. 523 (a)(6) where the debt arose from the willful and malicious conduct of the Debtor.

The Debtor was the managing partner of a saloon that played music. Some of the music played belonged to members of the American Society of Composers, Authors and Publishers ("ASCAP"). ASCAP licenses the music of its members. ASCAP became aware of the saloon playing music belonging to its members and offered to sell debtor a license, however received no response. ASCAP attempted to contact the Debtor twice in person, 14 times by mail and 28 times by telephone. After ASCAP received no response to its attempts to contact the Debtor, it sent an investigator to the saloon that observed songs belonging to ASCAP members played without a license. ASCAP brought suit against the Debtor for Federal copyright law infringement and judgment was entered against Debtor. Debtor subsequently filed for bankruptcy protection and ASCAP argued that the judgment owed to it should not be discharged under § 523 (a)(6) as the debtor's actions were willful and malicious.

11 U.S.C. § 523 (a)(6) provides that a debt is not discharged from an individual debtor if the debt was "for willful and malicious injury by the debtor to another entity or to the property of another entity." In the Eighth Circuit the elements of malice and willfulness must be analyzed separately.

"The word 'willful' in (a)(6) modifies the word 'injury,' indicating that nondischarbeability takes a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury." The 'willful' element is a subjective one. The debtor must intend the injury. Because ASCAP had attempted to contact the debtor 44 times, the Bankruptcy Court found it unlikely that the Debtor was not aware of any of the attempts to contact him. The BAP deferred to the lower Court, noting that "[d]ue regard must be given to the opportunity of the bankruptcy judge to assess the credibility of the witnesses."

"Malice requires more than just reckless behavior by the debtor." In order to establish malice the "defendant must have acted with the intent to harm, rather than merely acting intentionally in a way that resulted in harm." The Debtor's actions were malicious in this case because he did not obtain a public performance license and continued to play music covered by the license, in violation of Federal copyright law. The Eighth Circuit has held that violation of a statute may be viewed as evidence of malicious intent. Noting that the Debtor admitted having some general knowledge of Federal copyright law and royalties, the BAP found that the "debtor knew or should have known that the natural consequence of a failure to obtain a license is financial harm," as a result the BAP concluded "that the debtor intended to bring about the loss" that was suffered.

Debt Based on a Debtor's Willful and Malicious Conversion Through Entities He Controlled Is Nondischargeable

In the chapter 7 case of *Phillips, et al. v. Phillips (In re Phillips)*, Adv. No. 11-3400 (Bankr. D. Minn. Feb. 22, 2013), the court held that the plaintiffs' debt was nondischargeable under 11 U.S.C.

section 523(a)(6) due to the debtor's intentional conversion of property through entities he wholly owned or controlled.

The plaintiff sued the debtor (her step-son) in both her individual capacity and as personal representative of the estate of her late husband, the debtor's father. The other plaintiff to the action was an entity for which she was the sole member, officer and governor.

Prior the debtor's bankruptcy filing, he was the chief executive, majority owner and individual in control of two corporations. He and those corporations were sued by the plaintiffs in state court for conversion of property. The bankruptcy filing stayed the proceedings against the debtor, but not against the corporate defendants, and that action proceeded to trial in the state court.

The state court found that the debtor removed and disposed of the property at issue and that his corporations wrongfully converted plaintiffs' property. The state court awarded judgment in favor of the plaintiffs in the total amount of approximately $256,000. At issue before the bankruptcy court was whether the debtor was personally liable for those conversions. The court observed that the automatic stay was the only reason judgment was not entered against the debtor personally. The debtor testified in the state court trial, and also before the bankruptcy court, giving testimony that was substantially the same. The court found the debtor's testimony to be "entirely without creditability."

Ultimately, the court found that the evidence demonstrated that the debtor personally controlled the decisions to take the property, dispose of the property and disburse proceeds to himself and his corporations knowing that the property was converted and that neither he nor his corporations had any legal right to the property or proceeds. Accordingly, the court found that the debtor's actions were "blatant personal acts of willful and malicious conversion of property which he knew belonged to the plaintiffs." The resulting liability was found to be nondischargeable under 11 U.S.C. section 523(a)(6).

This case is currently on appeal to the Bankruptcy Appellate Panel for the Eighth Circuit Court of Appeals. *Phillips, et al. v. Phillips (In re Phillips)*, No. 13-6019 (B.A.P. 8th Cir. filed Apr. 26, 2013).

Debtor Lacks Standing to Appeal Order Approving Compromise

In *Leanna S. Peoples v Stuart J. Radloff*, _____ (8th Cir. 2013), the Eighth Circuit Court of Appeals held that a Chapter 7 debtor lacked standing to appeal an order approving a compromise because the debtor lacked a pecuniary interest in the order approving the compromise.

In 2009, Leanna S. Peoples ("Peoples"), commenced a state court action against her employer in which she alleged employment-discrimination claims. In April 2011, Peoples filed a voluntary petition under Chapter 7 of the United States Bankruptcy Code. Peoples did not list the then-pending state court action as an asset on her schedules. Peoples was granted a discharge in August 2011, and her Chapter 7 case was closed as a no asset case.

Shortly thereafter Peoples's employer moved for summary judgment in the state court action based on Peoples failure to disclose the case in her bankruptcy schedules. Peoples, in response, moved to reopen her Chapter 7 case.

The bankruptcy court granted Peoples motion and her case was reopened. The Chapter 7 trustee then determined that the state court action was an asset of the estate subject to administration for the benefit of creditors.

In September 2012, the Chapter 7 trustee filed a motion to approve a compromise between the trustee and Peoples's employer with regard to the state court litigation. The motion was served on Peoples and the creditors. Peoples did not object to the trustee's proposed compromise and the bankruptcy court granted the trustee's motion.

Shortly after entry of the order approving the compromise, Peoples filed a motion for leave to object to the trustee's proposed compromise and to set aside the order approving the same. Both the trustee and Peoples's employer objected to the motion on the grounds that Peoples lacked standing because she did not have a pecuniary interest in the state court litigation. The bankruptcy court agreed. Peoples appealed to the Bankruptcy Appellate Panel ("BAP").

In affirming the bankruptcy court's decision, the BAP found that Peoples lacked standing to challenge the proposed compromise because she did not have a pecuniary interest in the state court litigation and rejected Peoples' argument that a pecuniary interest for standing could be based on potential value.

The Eighth Circuit began its analysis by noting that standing in a bankruptcy appeal is narrower than Article III standing and is limited to a person with a financial stake in the bankruptcy court's order. In other words, standing is limited to those who are directly and adversely affected pecuniary by the order.

As the Court noted, upon the filing of a petition the debtor's assets become property of the estate, a debtor rarely has a pecuniary interest in how the trustee administers those assets. If, however, the debtor can show a reasonable possibility of a surplus after all debts are satisfied then the debtor has established a pecuniary interest for standing purposes.

In affirming the BAP, the Eighth Circuit noted that the value of the claims filed against Peoples's bankruptcy estate exceed the amount of the settlement agreement proposed by the trustee. Thus, because the amount owed to creditors exceed the amount of the settlement, no surplus existed and Peoples did not have a pecuniary interest in the bankruptcy court's order. Accordingly, Peoples lacked standing to appeal the order approving the compromise.

Bankruptcy Court Must Abstain from Exercising Jurisdiction Over State Claims

In *Ritchie Capital Management, L.L.C., et. al v. Opportunity Finance, L.L.C., et. al.*, _____ (D. Minn 2014), the United States District Court for the District of Minnesota held that it was required to abstain from exercising jurisdiction over certain state law claims and remanded the case to the state court.

This case arose out of the never-ending and unfortunate saga that is the Tom Petters' ("Petters'") related cases. The Plaintiffs (collectively, the "Ritchie Parties") invested money in one of Petters's schemes. Defendants (collectively, the "Opportunity Parties") loaned money to two Petters' special purpose entities. The Ritchie Parties allege that they were roped in Petters's fraud as a result of the Opportunity Parties' demand for immediate loan repayment after discovering Petters's fraud. According to the Ritchie Parties, the Opportunity Parties knew that the only way they would be repaid was if Petters's continued to defraud new investors and that they were such an investor.

In September 2013, the Ritchie Parties commenced an action against the Opportunity Parties in Minnesota state court alleging claims of aiding and abetting fraud, civil conspiracy and unjust enrichment. The Opportunity Parties removed the action to federal district court pursuant to 28 U.S.C. 1334(b). Shortly thereafter, the Ritchie Parties sought the district court's abstention from exercising jurisdiction of the proceeding as well as a remand to state court.

The Court started its analysis by noting the standard for mandatory abstention under 28 U.S.C. 1334(c)(2). As the Court stated, a court must abstain when: (1) a party to the proceeding files a timely motion to abstain; (2) the proceeding is based upon a state law cause of action; (3) the proceeding is a related (non-core proceeding); (4) absent § 1334(b), the cause of action could not have been commenced in federal court; (5) the proceeding is commenced in state court; and (6) the proceeding can be timely adjudicated in a state forum. The parties only dispute factors 3, 4 and 6.

The Court first addressed factor four, where there was a basis for federal jurisdiction outside of 28 U.S.C. 1334(b). In rejecting the Opportunity Parties contention that diversity jurisdiction might exist, the Court found that none of the pleadings or evidence in the case support a finding that diversity jurisdiction exists and, as the Court noted, the Opportunity Parties' notice of removal did not identify diversity jurisdiction as basis for removal.

With regard to the sixth factor, the Court stated that the relevant inquiry was not whether the proceeding may be resolved more quickly out of state court, but whether it could be "timely adjudicated" in state court. In that respect, the state court is to be given great deference and a afforded presumption of timely adjudicating its cases. Based on the evidence before it, the Court held that the state court was fully competent to handle the matter and adjudicate it in a timely manner.

Finally, the Court addressed factor three, whether the proceeding was a related (non-core) proceeding. As the Court noted, the Eighth Circuit applies to the board "conceivable effect" test to determine whether the proceeding is "related to" a bankruptcy proceeding. Applying that board standard the Court held that the state law claims were related to the bankruptcy proceedings because, if successful, the Ritchie Parties may recover funds that would otherwise go the trustee.

Having determined that all of the factors

for mandatory abstention were satisfied, the Court absented from exercising jurisdiction over the proceeding and remanded it to the Minnesota state court.

Funds Held by Debtor for the Benefit of Another Are Included in the Bankruptcy Estate if No Express or Constructive Trust Shields the Funds

In *In re Web2B Payment Solutions, Inc.*, 515 B.R. 716 (D. Minn. 2014), a check cashing company hired the debtor to process checks. At the time of its bankruptcy filing, the debtor held $933,000 in proceeds from the check processing activities in accounts with a non-party bank. The bank turned these funds over to the trustee. The check cashing company filed an adversary proceeding to have the check proceeds returned, arguing that it had an equitable interest in the proceeds via an express or constructive trust that existed between it and the debtor. The bankruptcy court granted summary judgment in favor of the trustee, holding that no trust existed, and that the check proceeds were property of the bankruptcy estate. The check cashing company appealed to the Minnesota District Court.

The district court affirmed, finding that the check cashing company had no equitable interest. The court stated that there could be no express or constructive trust because there was no separation of funds or intent to create a trust. Additionally, the court stated that they would not impose a post-petition constructive trust because this did not rise to the level of unjust enrichment or illegal behavior.

Allowing a Debtor to Reuse Loan Funds Rather Than Repay May Constitute an Extension or Renewal of Credit for the Purposes of Non-Dischageability under § 523(a)(2)(A).

The creditor in *In re Juve*, 761 F.3d 847 (8th Cir. 2014) brought an adversary proceeding seeking declaration that the loans made to the Chapter 7 debtor were non-dischargeable under 11 U.S.C. § 523(a)(2), (4), or (6). The creditor had loaned the debtor various amounts between 2003 and 2008 to purchase vehicles for the debtor's car dealership. During this time, the creditor allowed the debtor to reuse the funds received from the same of those vehicles to purchase more vehicles instead of repaying the loans. The debtor made several false representations to the creditor regarding the financial health of the dealership, the existence of a life insurance policy in favor of the creditor, and the use of the creditor's funds.

The bankruptcy court held that the creditor's loans were non-dischargeable under 11 U.S.C. § 523(a)(2)(A). On appeal, the Bankruptcy Appellate Panel for the Eighth Circuit Court of Appeals reversed the bankruptcy court's decision, and on remand the bankruptcy court again found the loans were non-dischargeable. This decision was once again reversed by the BAP, and the creditor appealed to the Eighth Circuit. The Eighth Circuit had to determine if bankruptcy court was clearly erroneous in finding that the reuse of loan funds constituted an extension or renewal of credit.

The Eighth Circuit held that categorizing the reuse of loan proceeds to purchase additional vehicles as a renewal or extension of credit was a "permissible view of the evidence," and reinstated the

bankruptcy court's finding that the loans were non-dischargeable.

Eighth Circuit Dismisses Appeal Due To Lack of Jurisdiction under 28 U.S.C. § 158(d) Because Determination of Dischargeability of an Attorney-Fee Award Was Not a Final Order

In *Clear Sky Properties, LLC. et al. v. Blake Roussel (In re Roussel)*, 14-1150 (8th Cir.), the Eighth Circuit Court of Appeals dismissed the appeal due to lack of jurisdiction under 28 U.S.C. § 158(d).

Prior to the debtor's bankruptcy, the creditor obtained a state court judgment against the debtor that the debtor breached fiduciary and contract duties to the creditor. The state court judge granted attorney fees "based on the arguments in the Motion and Brief." The motion and the brief referenced both the contractual operating agreement and a state statute, and the judge did not specify the claims or apportion the attorney fees accordingly. The creditor filed an adversary proceeding against the Chapter 7 debtor alleging that the debt was not dischargeable because the debtor committed defalcation as a fiduciary under 11 U.S.C. § 523 (a)(4), and engaged in willful and malicious conduct under 11 U.S.C. § 523 (a)(6).

The bankruptcy court refused to apply collateral estoppel to the state court judgment and determined that the damages and the attorney fees were dischargeable. The district court reversed, applying collateral estoppel to find that the debt arising from the breach of fiduciary duty was nondischargeable and remanding the attorney-fees for further consideration. The district court specifically ordered that the bankruptcy court consider whether the fee provision of the contract renders any or all of the attorney-fee award nondischargeable. The debtor appealed the district court's decision, arguing that the bankruptcy court correctly determined that the attorney-fee debt was dischargeable. The Eighth Circuit Court of Appeals dismissed the debtor's appeal for lack of jurisdiction under 28 U.S.C. § 158(d).

Neither the debtor nor the creditor raised the issue of jurisdiction in this case. However, the Eighth Circuit addressed the issue of jurisdiction, finding that it "can hear appeals only from final decisions, judgments, orders, and decrees entered by district courts or bankruptcy appellate panels." *In re Farmland Indus., Inc.*, 567 F.3d 1010, 1015 (8th Cir. 2009), quoting *In re Popkin & Stern*, 289 F.3d 554, 556 (8th Cir, 2002). A remand from district court is final only where it leaves "ministerial duties for the bankruptcy court." *Id*. The court reasoned that an order is final and ministerial if "it effectively resolves the merits" such that the task on remand would not likely result in another appeal. Therefore, the Eighth Circuit determined that it first must consider whether the remand order was ministerial and required the bankruptcy court only to execute the order.

The Eighth Circuit determined that the district court's remand order was not ministerial or final because the bankruptcy court was tasked with determining whether the attorney fee award was dischargeable. The Eighth Circuit noted that a determination of dischargeability requires the court to conduct a factual and legal analysis, which

is a more substantial task than a ministerial task. In this case, the district court specifically ordered that "on remand, the Bankruptcy Court should consider whether the fee provision in Clear Sky's operating agreement renders all or any part of Appellants' fee award part of the nondischargeable debt in this case." *In re Roussel*, 504 B.R. at 527. Therefore, the district court's remand order requires the bankruptcy court to further develop the record to resolve the issue of whether the attorney fees are dischargeable.

The Eighth Circuit held that the remand order was not ministerial because it required the bankruptcy court to determine whether the contract connects the attorney fees to the fiduciary debt that is nondischargeable. Thus, the Eighth Circuit dismissed the appeal due to lack of jurisdiction because the district court's remand is not a final order.

Minnesota's K-12 Education Credit Is Exempt As Government Assistance Based On Need

In *Christians v. Dmitruk* (*In re Dmitruk*), 14-6023 (8th Cir. BAP), the court held that the Minnesota K-12 Education Credit is exempt under Minn. Stat. § 550.37, subd. 14, as "government assistance based on need"

A chapter 7 debtor elected Minnesota exemptions and claimed separate portions of his federal and state income tax refunds as exempt under Minn. Stat. § 550.37, subd. 14, as "government assistance based on need." The trustee objected. The bankruptcy court allowed the debtor to claim the portion of the state income tax refund for the Minnesota K-12 Education Credit (Education Credit) as exempt under § 550.37, subd. 14. The trustee appealed, and the BAP affirmed.

Minnesota Statute § 550.37, subd. 14, states that "[a]ll government assistance based on need…shall be exempt from all claims of creditors." The statute identifies several programs and types of assistance that are based on need, such as medical assistance, Supplemental Security Income, and MFIP diversionary programs. The Minnesota Education Credit ("Education Credit") is not specifically included in the statute; however, the statute specifies that enumerated examples are "non-exhaustive." The BAP found it significant that the Education Credit is a "refundable credit" for education-related expenses with a maximum credit per child and that the credit is "phased out at relatively low income levels." These characteristics are similar to the income thresholds applicable to the federal Earned Income Credit and the Minnesota Working Family Credit." The BAP also noted that the Education Credit is fully refundable so that if the credit exceeds an individual's tax liability, then the excess is paid with a refund check. In addition, individuals can assign this payment to participating institutions "and in effect, receive a loan that is paid directly to a third party provider of educational programs."

The BAP determined that to qualify as a need-based exemption, the refund must "address the basic economic needs of low-income recipients." The BAP adopted the analysis of *In re Tomczyk,* 295 B.R. 894 (Bankr. D. Minn. 2003), a prior bankruptcy court decision holding that the federal Earned Income Tax Credit was exempt as "government assistance based on need." The BAP reasoned that education is a "basic need of all children

in Minnesota" and that the purpose of the Education Credit "is to assist people with low incomes in providing an education for their children." The BAP determined that the Education Credit differed from the Minnesota property tax refund and the federal Additional Child Tax Credit, because both are also available to middle-income individuals earning more than $100,000 and $75,000 respectively. The BAP further concluded that the Education Credit is government assistance based on need under § 550.37, subd. 14, because it provides "direct payments or subsidies to address the basic economic needs of low-income recipients" in obtaining quality education for their children.

Court Dismisses Involuntary Petition, Finding All Three Petitioning Claimants Held Claims Subject To A "Bona Fide Dispute."

In *In re American Resource Energy LLC*, Case No. 14-30262, (Bankr. D. Minn.), the court examined whether three involuntary petitioners held claims that were "not contingent as to liability or the subject of a bona fide dispute as to liability or amount." The ability to trigger an involuntary bankruptcy is limited to parties holding claims with "a preponderate degree of firmness under non-bankruptcy law." In assessing these standards, the court analyzed: (1) the posture of the parties in the underlying dispute; (2) the nature and gravity of their factual and legal contentions; and (3) the relevant non-bankruptcy law at issue.

The putative debtor was a Minnesota LLC who contracted with businesses in China for manufacturing wind power equipment. The putative debtor and its principal also entered into contracts for the sale of goods, facilitated creation of intermediary Chinese entities and obtained investments from the counter parties (although the form of such investments was unclear). Control over the entire enterprise became the focus of dispute, which spawned lawsuits and the involuntary petition.

The court found a bona fide dispute existed with respect to two of the claims in active litigation. The court examined pleadings in the non-bankruptcy litigation to conclude that the putative debtor had colorable defenses. The court found the third claim was also subject to a bona fide dispute, as it was plausible that the claimant held equity rather than debt. Although the existence of bona fide dispute is a factual determination, the court made its determinations on the written record and dismissed the involuntary petition. While the court used a summary judgment procedure, its analysis used language more redolent of a motion for judgment on the pleadings. For example, the court inquired: "is there an objectively plausible and legally-colorable basis on which [the putative debtor] contends it is not liable to the three Petitioners on the bases and to the extent the Petitioners assert?"

Student Loan Debt May Not Be Classified As Separate Unsecured Debt

In *In re Jordahl*, Case No. 13-44757 (Bankr. D. Minn.), the court granted the trustee's motion and denied confirmation of the debtors' chapter 13 plan because the plan divided unsecured debt into two classes including non-priority unsecured claims and unsecured student loans.

The chapter 13 trustee objected to the debtors' plan because: (1) it unfairly discriminated against the debtors' unsecured creditors in violation of § 1322(b)(1), and (2) it provided for payments of post-petition interest on non-dischargeable debt without providing full payment of all allowed claims in violation of § 1322(b)(10).

Section 1322(b)(1) allows a plan to "designate a class or classes of unsecured claims, provided in section 1122 of this title, but may not discriminate unfairly against any class so designated…" The trustee argued the debtors' proposed plan unfairly discriminated because the holders of the student loan debt would receive repayment of 52% of their claims while the non-priority unsecured creditors would only receive 6% to 11% of their claims under the plan. The debtors cited § 1322(b)(5) in support for their separate treatment of the student loan debt arguing that the student loans are long-term debts requiring installment payments beyond the terms of the plan.

There is a split among courts as to whether the classification of unsecured claims qualifying under § 1322(b)(5) are subject to the unfair discrimination test found in § 1322(b)(1). The majority view holds that § 1322(b)(5) and § 1322(b)(1) must be read in conjunction, requiring any treatment of long-term debt under § 1322(b)(5) to satisfy the unfair discrimination analysis under § 1322(b)(1). The minority view holds that § 1322(b)(5) acts independently of § 1322(b)(1) and that long-term debt payments are excepted from the unfair discrimination analysis. The court adopted the majority approach.

The debtors had the burden of proving their proposed classification did not unfairly discriminate against the other unsecured class. The court undertook the analysis of unfair discrimination using the four-prong test under *In re Leser*, 939 F.2d 669, 672 (8th Cir. 1991), which considers whether: (1) the discrimination has a reasonable basis; (2) the debtor cannot carry out a plan without the discrimination; (3) the discrimination is proposed in good faith; and (4) the degree of discrimination is directly related to the basis or rationale for discrimination.

The debtors failed to establish that the discrimination was reasonable, failing the critical first element of the *Leser* test. Both parties further agreed that the debtors could not satisfy the second element of the *Leser* test because the student loan debt could have been combined with the other unsecured debt creating a confirmable plan. The debtors satisfied the third element of the *Leser* test by acting in good faith. The fourth element was inapplicable, based on the outcome of the first and second elements.

Eighth Circuit Affirms A Chapter 13 Lien Strip Of A Valueless Lien

In *Minnesota Housing Finance Agency v. Schmidt*, Case No. 13-2447, the United States Court of Appeals for the Eighth Circuit affirmed confirmation of a Chapter 13 plan that reclassified the third mortgage creditor's claim as unsecured and provided for the avoidance of the lien upon plan completion.

The creditor held a third mortgage secured only by the debtor's principal residence, but the value of the creditor's claim+-+ in the home was zero because the value of the home was less than the

balances of the first and second mortgages.

The court acknowledged that § 1322(b)(2) forbids a court to modify the rights of claimants who have a security interest only in the debtor's principal residence, but found the clause inapplicable because the mortgage holder did not hold a judicially-valued secured claim under § 506(a)(1). Therefore, § 1322(b)(2)'s protection did not apply, and the plan could freely modify the mortgage holder's rights.

The court supported its interpretation with the United States Supreme Court's ruling in *Nobelman,* a case involving only an attempt to modify an undersecured junior mortgage (i.e., a junior mortgage partially supported by the residence value). But in dicta the *Nobelman* court strongly implied that a mortgage holder had to demonstrate some value for its lien to gain protection under § 1322(b)(2).

The Eighth Circuit rejected other arguments based on analysis of related text, legislative history, and policy consequences.

District Court Affirms That Non-Lawyer Violated Bankruptcy Preparer And Debt Relief Agency Statutes And Engaged In The Unauthorized Practice Of Law

In *Jonak v. McDermott*, No. 13-1011, the United States District Court for the District of Minnesota affirmed the bankruptcy court's order and judgment that a non-lawyer individual advertising bankruptcy and credit counseling assistance violated the bankruptcy code and engaged in the unauthorized practice of law.

Jonak, who is not an attorney, owned and operated the Affordable Law Center. ALC was not a law firm and did not employ counsel admitted to practice in this district. Jonak maintained offices in several Minnesota cities.

Among the services ALC provided to customers were legal services plans for various subject matters, including bankruptcy. Advertisements for ALC's services used the word "law" and offered prospective debtors the opportunity to achieve "a low cost bankruptcy discharge" and avoid "contend[ing] with overly expensive bankruptcy fees charged by many attorneys and lawyers." ALC maintained a phone book listing under "Attorneys, Bankruptcy," Craigslist postings under "legal services," and newspaper advertisements offering bankruptcy filing services for just $680.

ALC accepted fees from nearly twenty debtors in this district. Among the services ALC performed were debt negotiation guidance, bankruptcy filing assistance, and post-bankruptcy credit guidance. With one exception, all debtors officially filed bankruptcies *pro se.*

According to the debtors, Jonak assisted in bankruptcy filings and gave legal advice regarding state and federal bankruptcy exemptions, homestead allowances, and discharge and dischargeability rules. He also explained the bankruptcy process and offered recommendations regarding the various available bankruptcy options. Several debtors were confused as to whether ALC was a law firm and whether Jonak was a lawyer.

After investigating Jonak's conduct, the

United States Trustee filed an adversary proceeding against Jonak and his corporate entities. The UST alleged that Jonak violated multiple provisions of the bankruptcy code, including §§ 110, 526(a), 527, and 528, and sought to enjoin Jonak from engaging in further violations of the law as well as recover various statutory fines and penalties.

The bankruptcy court held that Jonak and his entities functioned as bankruptcy petition preparers and violated § 110. It also held that Jonak offered and furnished legal advice and engaged in the unauthorized practice of law. It further found that Jonak engaged in fraudulent, unfair and deceptive acts prohibited by the bankruptcy code.

In addition, the bankruptcy court determined that ALC was a debt relief agency under the code and that it violated multiple provisions requiring clear and conspicuous advertising disclosures in the services to be rendered. According to the bankruptcy court, Jonak misrepresented the services provided, fostered the filing of untrue or misleading bankruptcy forms, and failed to provide various notices and disclosures to the debtors.

As a consequence, the bankruptcy court enjoined Jonak from committing further violations and ordered Jonak to forfeit and turnover fees received. The court also awarded liquidated damages.

The district court affirmed in all respects, reasoning that regardless of how Jonak characterized his services, he gave advice as to the bankruptcy process, the substantive law of bankruptcy, and the effect of both on the debtors' bankruptcy options. Further, his direct involvement in petition preparation and the debtors' substantive elections, justified the bankruptcy court's conclusions and relief afforded.

The district court also rejected Jonak's contention that he did not violate debt relief agency statutes inasmuch as Jonak failed to comply with disclosure requirements by relying on others to make disclosure.

U.S. Supreme Court Partially Resolves Issues Related To Stern Claims

In *Executive Benefits Insurance Agency v. Arkison*, No. 12-1200, the United States Supreme Court resolved one issue arising from its *Stern v. Marshall* decision, namely how courts should proceed toward entry of a final judgment when they encounter a fraudulent transfer claim.

Nicholas Paleveda and his wife owned and operated Aegis Retirement Income Services, Inc. and Bellingham Insurance Agency, Inc. By early 2006, BIA became insolvent and ceased operating. Paleveda then used BIA funds to incorporate Executive Benefits Insurance Agency. Paleveda and others continued to transfer assets from BIA to EBIA, including depositing BIA assets in an account held jointly by ARIS and EBIA, which were then credited to EBIA at year end.

BIA filed Chapter 7 bankruptcy in the United States Bankruptcy Court for the Western District of Washington in June 2006. Arkison, the Chapter 7 trustee, filed a complaint in the bankruptcy court against EBIA and others, alleging that BIA fraudulently transferred assets to EBIA.

The trustee filed a motion for summary judgment against EBIA, which the

bankruptcy court granted. EBIA appealed to the district court. After conducting *de novo* review, the district court affirmed and entered judgment for the trustee. EBIA appealed to the Ninth Circuit.

During the appeal, the Supreme Court decided *Stern*, holding that Article III of the U.S. Constitution did not permit a bankruptcy court to enter final judgment on a counterclaim under state law for tortious interference, even though § 157 of the Judicial Code (28 U.S.C.) identified such a counterclaim as a core proceeding. *Stern* held that the bankruptcy court lacked Constitutional authority to finally adjudicate certain core proceedings, trumping Congressional grant under § 157.

Given *Stern*, EBIA moved to dismiss its appeal, contending that Article III did not permit Congress to vest authority in a bankruptcy court to finally decide the trustee's fraudulent transfer claims.

The Ninth Circuit declined the motion and affirmed, concluding that EBIA had impliedly consented to the bankruptcy court's deciding the case and observing that the bankruptcy court's judgment could instead be treated as proposed findings of fact and conclusions of law, subject to *de novo* review of the district court. The Supreme Court granted certiorari.

The Supreme Court held that when a bankruptcy court is confronted with a claim that, while defined as core in § 157, it cannot otherwise Constitutionally adjudicate under *Stern*, the bankruptcy court should, absent consent of the parties, issue proposed findings of fact and conclusions of law, which the district court will then review *de novo* and enter judgment.

Applied to the case at bar, the Supreme Court held that the district court granted *de novo* review and issued a reasoned opinion affirming the bankruptcy court. The procedure accorded with the relief appellant would otherwise receive upon a successful appeal. As a result, the Supreme Court affirmed and did not reach the issue of whether EBIA impliedly consented to the bankruptcy court's jurisdiction.