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Editors-In-Chief:

Mychal Bruggeman
Manty & Associates, P.A.
(612) 465-0347
Mychal@mantylaw.com

Edwin H. Caldie III
Stinson Leonard Street LLP
(612) 335-1404
ed.caldie@stinsonleonard.com

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

Editorial Board:

James C. Brand
Fredrikson & Byron, P.A.
(612) 492-7408
jbrand@fredlaw.com

Andrea Cobery
Manty & Associates, P.A.
(612) 465-0909
Andrea@mantylaw.com

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

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

Editorial Board (continued):

Alex Govze
ASK LLP
(651) 289-3842
agovze@askllp.com

Karl J. Johnson
Office of Standing Chapter 13 Trustee
(612) 277-1223
kjj@ch13mn.com

Sarah M. Olson
Fredrikson & Byron, P.A.
(612) 492-7452
solson@fredlaw.com

Amanda Schlitz
Stinson Leonard Street LLP
(612) 335-1943
Amanda.Schlitz@stinsonleonard.com

Mary F. Sieling
Iannacone Law Office
(651) 224-3361
mfs@iannacone.com

Kesha Tanabe
ASK LLP
(651) 289-3845
ktanabe@askllp.com

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UNIFORM FIDUCIARY ACT CLAIMS REQUIRE ACTUAL KNOWLEDGE OF BREACH OF DUTY WHERE ACCOUNT IS NOT A FIDUCIARY ACCOUNT

Banks can be liable under Minnesota's Fiduciary Account Act only for failing to take action in response to dishonest acts committed by a person known by the bank as a fiduciary. Diversity jurisdiction can arise subsequent to filing a notice of removal upon dismissal of a non-diverse party.

In *Buffets, Inc. v. Leischow*, No. 12-2804, the Eighth Circuit affirmed dismissal of a complaint against two banks for alleged failure to comply with the Uniform Fiduciaries Act where they accepted customer deposits from a utility payment provider, the bankrupt. The utility provider routinely paid its customers' utility bills before collecting customer payments. This led to overdrafts, and even a credible accusation of check kiting. Moreover, the debtor commingled the customer deposits with other personal accounts not designated as fiduciary accounts. As non-fiduciary accounts, the banks were not presumed to know that funds in the account were held by debtor as a fiduciary. Utility users sued the depository banks after twice paying their utility bills since the debtor failed to remit their initial payments prior to bankruptcy.

The district court dismissed the claims and the court of appeals affirmed. The court first confirmed jurisdiction by ruling that while diversity did not initially exist due to the non-diverse presence of debtor's principal at the time of the notice of removal, diversity jurisdiction could vest subsequent to the notice once the plaintiffs dismissed the non-diverse party. The district court had also found "related to" jurisdiction but the court of appeals questioned whether the claim would impact the estate and thus opted to rely on diversity jurisdiction.

On the merits, the Eighth Circuit held that the bank lacked sufficient knowledge of any wrongdoing to sustain a UFA claim. Minnesota Statute § 520.09 governs deposits in a fiduciary's personal account and shields the depository institution from liability for receiving a deposit that breaches a fiduciary's obligations to a principal, "unless the bank receives the deposit…with actual knowledge that the fiduciary is committing a breach of an obligation as fiduciary in making such deposit…or with knowledge of such facts that its action…amounts to bad faith." It further provides that "[i]f a person who is a fiduciary makes a deposit" into the fiduciary's personal account, "the bank receiving such deposit is not bound to inquire whether the fiduciary is committing thereby a breach of an obligation as fiduciary."

The banks lacked actual knowledge of the alleged commingling and it was unclear whether the banks were even aware of the fiduciary relationship since the accounts were not designated as fiduciary accounts. While there were instances of overdrafts and even an instance of kite checking, the statute requires knowledge of specific acts

which constitute a fiduciary breach as to the entrusting plaintiff. A bank is not generally obligated to close accounts in response to patterns of irregular banking conduct in personal accounts. The lack of communications from the plaintiff to the banks as to the nature of the substantial deposits entrusted with the debtor payment facilitator also weighed against granting relief.

PETTERS SPECIAL PURPOSE ENTITIES SUBSTANTIVELY CONSOLIDATED

Special purpose entities (the "SPEs") used as instrumentalities in a Ponzi scheme may be substantively consolidated with the purveyor entity where sufficient facts show lack of separateness of the SPEs, consolidation will facilitate avoidance actions, and improve administration of the case. Defendants cannot claim *ex ante* reliance on the separateness of the SPEs where they failed to establish and protect that separateness prior to extending credit and during administration of the loans

In *Petters Company, Inc.*, (Bankr. No. 08-25257, D. Minn.), the trustee sought substantive consolidation in the context of more than a hundred adversary proceedings seeking recovery against defendants who received funds from the largest Ponzi scheme in Minnesota history. While PCI is generally considered the "engine of fraud," several lenders advanced funds through special purpose, bankruptcy-remote, entities, affiliated with PCI. By separating the entities from PCI, the lenders purportedly sought to isolate and protect their transactions from avoidance remedies in the event PCI went into bankruptcy. The legal separateness of each SPE borrower, created potential impediments to avoidance claims based on the lack of a predicate creditor for the SPE and the potential for the transferee lender to claim itself as a subsequent transferee.

The trustee sought to eliminate these impediments by moving to substantively consolidate PCI and the SPEs, *nunc pro tunc*. After a three day trial, the bankruptcy court granted relief. The court overcame scant case law in the Eighth Circuit by analyzing several significant cases from other federal districts and circuits. The court thoroughly reviewed case law developed elsewhere and the Eighth Circuit precedent in *In re Giller*, 962 F.2d 796 (8th Cir. 1992), and held that objective interrelation of the entities was the more significant factor in assessing the appropriateness of consolidation, as opposed to the defendants or creditors' *ex ante* expectation of separateness. Interrelationship can look at a variety of factors, including: commingling of assets and liabilities, difficulty in segregating assets and liabilities, and unity of operations and interests. In addition, to interrelatedness, the court should find that the consolidation will enhance and simplify administration of the bankruptcy case and likely return greater net value to creditors.

The court found these principles favored the trustee. First, the trustee

prevailed in establishing a sufficient interrelationship between PCI, on one hand, and its various SPEs, on other hand. Supporting facts in most instances included: common control and management of all entities by Petters; the SPEs did not conduct board meetings, have active independent directors, separate office space or separate overhead; PCI paid all expenses of the SPEs; commingling of SPE funds in the PCI bank account; and PCI and Petters guaranteed loans to the SPEs.

Second, the trustee prevailed in demonstrating consolidation would simplify and improve administration of the bankruptcy estates. Consolidation would eliminate the necessity to consider inter-company claims, and require all creditors and victims of the scheme look to a single pool of assets. The trustee's experts prevailed in establishing that creating separate accounting records and intercompany accounts for each entity posed an unreasonably burdensome task for little utility earned in exchange.

The court also considered the lenders' claims of unfairness due to their *ex ante* reliance on separateness, despite the fact that the court believed the Eighth Circuit may not factor such reliance. The court determined the lenders' claims of *ex ante* reliance carried little weight since several of them could not credibly show they relied on the separateness of the SPEs in extending credit. Several of the credit agreements made clear that the SPE's performance under the loan agreement depended on PCI collecting from retailers and repaying the SPE. In addition, lenders made loans based on the creditworthiness of PCI, required guaranties from PCI, took security interests or assignments in PCI assets, or required PCI to participate in the loans. Further, the evidence showed that lenders learned facts demonstrating commingling among entities but did not substantially change their administration of the credits. Lenders also accepted payments that came from a source other than their own SPE. The court also credited expert testimony establishing that the lenders did not perform reasonable due diligence for purchase-order financing. With respect to one of the lenders who successfully ignored PCI as a source of bolstering the credit, the lack of due diligence exercised yet ultimately doomed its claim of *ex ante* reliance.

Finally, consolidation would promote and simplify the prosecution of avoidance actions, particularly since consolidation would eliminate certain objections based on standing that the SPE lenders could raise. The court found that consolidation would not harm the SPE defendants in their role of creditors. To the contrary, consolidation would appear to increase recoveries for all creditors. Further, only one of the SPE parties had filed a proof of claim. The court granted substantive consolidation *nunc pro tunc* to the commencement of the cases, except that it preserved avoidance claims held by each SPE estate so that no argument could arise that consolidation eliminated such claims.

PLEADING STANDARDS ARE DIFFERENT WHEN A PONZI SCHEME IS ALLEGED

In *In re Petters Company, Inc. et.al*, in the United Stated Bankruptcy Court for the District of Minnesota, Case No. 08-45257, the court issued the Third Memorandum on "Consolidated Issues" Treatment of Motions for Dismissal in Trustee's Litigation for Avoidance and Recovery: Avoidability and Actionability Under Law and in Equity; One Last Issue of Pleading (the "Third Memorandum"). The Third Memorandum was issued as the basis for the disposition of pending motions for dismissal in a docket of adversary proceedings relating to the Ponzi scheme conducted by Thomas J. Petters. The Third Memorandum makes clear that the analysis for fraudulent transfers is different for bankruptcies dealing with Ponzi schemes than traditional fraudulent transfer actions.

Certain lender defendants argued that there cannot be a valid claim for a fraudulent transfer, based on actual fraud or constructive fraud, where payments by the debtors were made in repayment of loans and treated as such by the parties due to a lack of intent. The bankruptcy court compared the facts of the case to several others where loan payments were alleged to have been fraudulent transfers and distinguished each one. The court noted that where an alleged fraudulent transfer originates from a Ponzi scheme the factual allegations required are different than other types of cases as "fraudulent intent is properly assumed to pervade the operation of a Ponzi scheme." In other words, where a Ponzi scheme is alleged, such pleading satisfies the intent element of a fraudulent transfer.

Based on this premise, the bankruptcy court held that "the Trustee has pleaded that payments made to lender-defendants were done in furtherance of a Ponzi scheme, and the operational aspects of the scheme were pleaded at length; so, complaints seeking avoidance of such payments are not subject to dismissal as a matter of law."

The court next looked at whether payments on loans interlaced with a Ponzi scheme provide reasonably equivalent value for the purpose of determining if the transfers made were constructively fraudulent under Minnesota statute and the Bankruptcy Code. The court noted that under Minn. Stat. § 513.43(a) value is defined as "property, or satisfaction or securing of a present or antecedent debt of the debtor" and under 11 U.S.C. § 548(d)(2)(A) "[v]alue is given for a transfer…if, in exchange for the transfer…an antecedent debt is secured or satisfied…" The lender defendants claimed that all payments were on account of value by definition as they were on account of debt owed. The defendants argued that both the principle and interest paid by the transfers in question were for value as they satisfied antecedent debts dollar for dollar on account of the amounts due under the loan agreements.

After noting the inequities of paying some lenders in full for both principle and interest on loans while others do not get paid at all, and the net result that there would be some net big "winners" and net big "losers," the court found that the "repayment of paid-in equity investment is not avoidable as constructively-fraudulent" as it provides value to the estate. "The return of capital or investment improves the balance sheet of the vehicle-entity by reducing debits to net worth." Because victims of a Ponzi scheme would have a claim for restitution, the repayment of the principal borrowed constitutes reasonably equivalent value in that it satisfies an antecedent debt on account of the claim that the recipient of the transfer would have had.

The court, relying on *Scholes v. Lehmann*, 56 F.3d 750 (7th Cir. 1995), found that the profit, or interest, paid on a loan in a Ponzi scheme is avoidable as it does not provide any value to the estate. The only "consequence of the payment and receipt is the prolongation of a fraudulent shell, and the piling-up of further harm to future investor-infusers." Regardless of a contractual requirement to pay the interest, paying the same does not constitute value to the estate as the "payment-out of ostensible interest has no corresponding input received by the vehicle-debtor."

The lender defendants further argued that under 11 U.S.C. § 548(c) and Minn. Stat. § 513.48(a), the transfers are not avoidable as the defendants allegedly received the transfers for value and in good faith, the two requirements of the affirmative defense. They argue that by definition they received the transfers in good faith because they were made within the terms called for under the loan agreements and additionally that the trustee did not allege sufficient facts that the defendants did not receive the transfers in good faith.

The court, reiterating its analysis of what constitutes value in the context of a Ponzi scheme, held that for all transfers constituting interest or profit there could be no reasonably equivalent value, and thus the affirmative defense could not apply to those portions of the transfers representing profit or interest. Those portions of the transfers representing payments on principle, which constitute value, are subject to the affirmative defense. The court found however that because it is an affirmative defense the trustee did not have a burden to plead a lack of good faith. Although the court noted that the trustee did make reference to abnormally high interest rates in the complaints, it was not his burden to anticipate a potential affirmative defense being raised.

The court next examined the trustee's avoidance claims against 26 former employees of the debtors (the "Alleged Insiders") that he alleged were insiders under Minn. Stat. § 513.45(b)(1). The Alleged Insiders argued that the trustee failed to plead sufficient facts to prove that they were insiders. The court noted that under Minn. Stat. §

513.41(7) and the similar insider provision under the Bankruptcy Code, 11 U.S.C. § 101(31) the term insider is defined by including certain classes of individuals including under the Minnesota Statute "(ii) if the debtor is a corporation, (A) a director of the debtor; (B) an officer of the debtor; (C) a person in control of the debtor…" "Most of these provisions exemplify 'insider' by concrete characteristics. However, the concept encompasses any entity that had 'a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arm's length with the debtor.'"

For those Alleged Insiders that were officers or directors of the debtors, the trustee adequately pleads insider status by alleging that the individual falls into one of these enumerated classes. For those Alleged Insiders that may be considered insiders by virtue of being a "person in control of the debtor," the "issue is fact intensive and the determination must be made on a case-by-case basis." In order to establish insider status based on the "person in control" provision, there must be something "beyond arms-length, about the transaction that featured the transfer," "a closeness of relationship alone is not sufficient to establish insider status."

To plead insider status as a person in control of the debtor, facts concerning actual exercise of control must be plead. It is insufficient to plead conclusory statements that the individual had a favored position or was in the preferred circle, rather "the Trustee must plead that a defendant had a status with, or access to, persons in control of a debtor, with a corresponding close relationship and the opportunity to influence the decision-making…coupled with specific allegations that the transfers to the defendant were not at arm's length."

The court next examined whether the trustee's alternative theory of recovery under the equitable doctrine of unjust enrichment could proceed. The court noted that most of the trustee's allegations with regard to the unjust enrichment causes of action mirrored the trustee's fraudulent transfer claims. Minnesota Courts have held that a "party may not have equitable relief where there is an adequate remedy at law available." Where there is adequate remedy available at law, allowing unjust enrichment recovery would allow "recovery, despite law to the contrary, merely because the plaintiff fashioned the pleadings in a certain way." Because of the existence of the fraudulent transfer claims based on the same facts as the unjust enrichment claims, the unjust enrichment claims must be dismissed.

BAP HOLDS THAT OBLIGATIONS LISTED AS UNSECURED IN GUARANTIES BECAME SUBSEQUENTLY SECURED VIA CROSS-COLLATERALIZATION LANGUAGE IN DEED OF TRUST

In *Arvest Bank v. Cook et al.* (*In re: Russell Lee Cook et al.*), No. 13-6014

(8th Cir. BAP, November 19, 2013), at issue was Empire Bank's appeal from the bankruptcy court's order that (1) Arvest Bank's judicial lien is superior to the liens asserted by it; and (2) directing judgment in favor of the debtors on their preferential transfer claim against Empire.

The debtors owned interests in various entities and had lending relationships with both Empire and Arvest. The debtors also owned several parcels of real property, including two in Taney County.

In June 2007, the debtors provided guaranties to Empire, under the terms of which they guarantied the payment and performance of each and every debt, liability, and obligation of every type and description each entity in which they owned interests had to Empire. The guaranties state they are unsecured.

Thereafter, the debtors' entity executed two promissory notes in favor of Empire that were secured by deeds of trust recorded in Greene County. After a default, Empire foreclosed. It then sued the debtors for deficiency judgments, which resulted in a confession of judgment executed by the debtors in September 2011. Empire filed the confession in Taney County even though it had not yet been entered as a judgment in Greene County. The Greene County court accepted the confession and entered judgment in February 2012. The judgment was then filed in Taney County.

Empire begin to execute on its judgment against the debtors' real property in Taney County, reaching a settlement in May 2012 whereby Empire received an assignment of two promissory notes receivable held by the debtors.

The debtors also granted a deed of trust to Empire in October 2007, which encumbered portions of real property the debtors owned in Taney County. The deed of trust defined "secured debt" to include all "future obligations of [debtors] to [Empire]" and "all obligations [debtors] owe to [Empire] which now exist or may later arise …."

Meanwhile, in April 2010, Arvest commenced litigation in Taney County against the debtors and others for liability on certain promissory notes and guaranties. The court entered judgment in that action in December 2011.

In March 2012, Arvest filed an action for declaratory judgment in state court against Empire and the debtors, asserting that Empire's deed of trust was not supported by valid consideration or any existing indebtedness. Arvest also asserted that its judgment lien was superior to Empire's judgment lien as against the debtors' Taney County real property.

The debtors filed a Chapter 11 voluntary petition in July 2012. The state court action was removed to the bankruptcy court and the debtors filed a cross-complaint against Empire to set aside certain alleged preferential transfers involving the two promissory

notes receivable and seeking a declaration that Empire held no valid deed of trust against their Taney County real property.

The bankruptcy court found that Empire's deed of trust was invalid for lack of consideration and did not secure the debtors' obligations pursuant to their guaranties signed in connection with the prior transaction. The court also found that Empire's recording of the confession in Taney County prior to its entry of judgment was a nullity and therefore Arvest's judgment lien had priority. Finally, the court found that the debtors' transfer of interest in two promissory notes to Empire were avoidable as preferential transfers.

The BAP reversed and remanded, holding first that Empire's promise to loan money to the debtors was itself valid consideration. Second, the BAP determined that the cross collateralization language in the Empire deed of trust was not ambiguous as the "unsecured" language in the guaranties was true when the debtors signed and the obligations later became "secured" when the debtors executed the Empire deed of trust. The change in circumstances did not create an ambiguity as to whether the guaranty obligations became subsequently secured. In light of these holdings, the BAP remanded for the bankruptcy court to reconsider its preference analysis on the debtors' counterclaim.

SHAREHOLDER STANDING RULE DOES NOT APPLY IN A BANKRUPTCY APPEAL WHEN LLC PRINCIPAL DOES NOT HAVE A SEPARATE AND DISTINCT INJURY

In the case of *Conway v. Heyl (In re Heyl)*, No. 13-6022 (B.A.P. 8th Cir. Dec. 12, 2013), the bankruptcy court denied the principal of an LLC's motion for relief under Rule 60 of the Federal Rules of Civil Procedure. The BAP dismissed the LLC principal's appeal for lack of standing.

The LLC invested in two of the debtor's real estate development ventures. When one venture failed, the debtor made promises to the LLC principal regarding the stability of transferring the LLC's investment from the failed venture over to the second venture. The debtor filed for relief under Chapter 7, and the bankruptcy court held that while the debtor made false representations about the second venture, the LLC and principal failed to prove that transferring the investment was the proximate result of the misrepresentations. The LLC and the principal, together, filed a motion for relief from judgment citing Rule 9024 and Rule 60 of the Federal Rules of Bankruptcy Procedure and Federal Rules of Procedure, respectively. The motion asserted after-acquired evidence to prove that some testimony at trial was false regarding the financial condition of the second venture. The bankruptcy court denied the motion, concluding that the LLC and principal had not shown why the after-acquired

evidence could not have been discovered before trial, and regardless, the movants lack damages because the investment would be virtually worthless today even if it was not transferred. The LLC was subsequently dismissed from the appeal, and the LLC principal proceeded *pro se*.

Before reaching the merits of whether the bankruptcy court abused its discretion under Rule 60.02 for reviewing a motion regarding after-acquired evidence, the BAP first examined whether the LLC principal had standing to appeal. Bankruptcy case appellate standing is more limited than Article III standing, and it is restricted to persons with a financial stake, meaning they were directly and adversely affected by the order.

Notwithstanding the fact that the LLC principal was a plaintiff in the adversary bankruptcy proceeding, the BAP concluded that he was not directly and adversely affected by the order denying the motion for relief because the motion only affected the LLC's interests. The principal did not have a separate and distinct injury apart from the LLC, and there was nothing in the record to suggest that the LLC could not assert the claim directly. Thus, the BAP dismissed the appeal for lack of standing.

CHILD TAX CREDIT IS NOT AN EXEMPT PUBLIC ASSISTANCE BENEFIT

In the Chapter 13 case of *Hardy v. Fink (In re Hardy)*, No. 13-6029 (B.A.P. 8th Cir. Dec. 23, 2013), the BAP affirmed the bankruptcy court's order sustaining the Trustee's objection to the debtor's claimed public-assistance exemption for her refund from a Child Tax Credit.

The debtor filed for relief under Chapter 13, and she sought to claim, as exempt, the portion of her federal income tax refund that was attributable to a Child Tax Credit allowed under 26 U.S.C. § 24. The Trustee objected to the claim, and the bankruptcy court sustained the objection, concluding that the Child Tax Credit is not an exempt public-assistance benefit.

The bankruptcy estate that is created when a petition for relief is filed includes all of a debtor's legal and equitable interests, including interests in future tax-refund payments. On appeal, the BAP recognized that public-assistance benefits may be excluded from a bankruptcy estate pursuant to 11 U.S.C. § 522(b)(1). The debtor argued that a public-assistance benefit is simply any assistance that benefits the public. The BAP rejected this broad interpretation and instead relied on the dictionary definition to determine the plain and ordinary meaning of the term. In three leading dictionary sources, the BAP found that, in relevant part, public assistance is government aid intended for the needy. The Child Tax Credit maintains high income thresholds based on filing status (e.g., $110,000 for married individuals filing jointly), and the BAP concluded that such individuals cannot be said to be needy. Citing numerous cases for support, the BAP stated that

the Child Tax Credit was not enacted solely to assist lower income families, and in fact, it primarily benefits middle class Americans.

The BAP rejected one decision from the United States Bankruptcy Court in the Central District of Illinois that arrived at the opposite conclusion. The BAP criticized this decision because it failed to consider the fact that the Tax Credit was written to be unavailable to those below a certain income level—$10,350 at the time of that decision. The BAP resolved that any benefit that is not available to the *most* needy cannot be considered a public-assistance benefit for purposes of bankruptcy estate exemptions.

PROTECTIONS OF § 364(e) APPLY TO DIP FINANCING ORDER

In the Chapter 11 case of *In re Western Star Transportation, LLC*, No. 13-6062 (B.A.P. 8th Cir. Jan. 28, 2014), the existing secured creditor held a pre-petition first priority lien on the debtor's property, including accounts, inventory, office equipment, general intangibles and certain other equipment. Shortly after filing its petition, the debtor filed a motion for DIP financing on terms which included the grant of superpriority administrative expense status for the DIP lender, which was to be ahead of all other administrative expenses, existing liens and security interests.

The secured creditor objected to the motion, and the bankruptcy court conducted a final hearing and authorized the financing. According to the secured creditor, the debtor did not even discuss the good faith of the DIP transaction at the hearing and the bankruptcy court failed to make findings regarding the same. The secured creditor appealed the DIP financing order, and did not obtain a stay pending appeal. The debtor moved to dismiss the appeal as moot, and the DIP lender joined in that motion.

The BAP noted that contrary to the claims of the secured creditor, the DIP financing order made a clear finding of good faith under section 364(e): "Lender has acted in good faith in agreeing to extend credit," "[t]he terms . . . are for reasonably equivalent value and fair consideration," "[t]he agreements and arrangements . . . have been negotiated at arms' length with all parties represented by experienced counsel, are fair and reasonable under the circumstances, . . . have been entered into in good faith," and "[a]ny credit extended . . . shall be deemed to have been extended in good faith, as that term is used in § 364(e) of the Code." The B.A.P. rejected the secured creditor's argument that this recitation of good faith was merely a "cursory conclusion" that was "recited perfunctorily" in the DIP financing order.

Section 364(e) provides that "[t]he reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity of

any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, . . . unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal." 11 U.S.C. § 364(e).

The BAP explained that the purpose of section 364(e) is to "encourage lenders to extend credit to debtors in bankruptcy by eliminating the risk that any lien securing the loan will be modified on appeal." In looking to whether the protections of section 364(e) apply to a DIP financing transaction, the court considers (1) whether the party challenging the order obtained a stay pending appeal; and (2) whether the lender acted in good faith in extending the new credit. Here, it was undisputed that the secured creditor did not obtain a stay pending appeal. The BAP did not address whether the failure to obtain a stay pending appeal would, on its own, merit dismissal of the appeal, because it found that the bankruptcy court properly determined that the DIP lender acted in good faith.

The BAP observed that while the secured creditor asserted the bankruptcy court's finding of good faith was unsupported by the record, it did not allege that the DIP lender extended the credit in bad faith and did not provide any basis upon which the bankruptcy court should have made such a finding. The BAP further indicated that the fact that the maximum amount of the DIP loan had not been reached would not change its decision, suggesting section 364(e) would be superfluous if a DIP lender were required to bear the same risks as an ordinary lender in the event of an incomplete DIP transaction. The debtor had utilized the DIP financing to the extent its operations required. Finding that the bankruptcy court made a clear statement of good faith under section 364(e) in its DIP financing order, the BAP dismissed the appeal as moot.

FALSE REPRESENTATIONS REGARDING INTENDED USE OF LOAN PROCEEDS EXCEPTS DEBT FROM DISCHARGE UNDER § 523(A)(2)(A)

In the Chapter 7 case of *Community Finance Group, Inc. v. Fields (In re Fields)*, Adv. No. 10-5019, (Bankr. D. Minn. Nov. 7, 2013), the bankruptcy court found the debtor liable to the plaintiff and excepted the debt from discharge under section 523(a)(2)(A). On appeal, the BAP considered whether the bankruptcy court clearly erred in finding that (1) the debtor made a misrepresentation to the plaintiff regarding the intended use of the loan proceeds; and (2) the plaintiff justifiably relied on that misrepresentation. Finding no clear error, the BAP affirmed.

The bankruptcy court set forth the complex factual background of the case and made detailed findings following trial. The simplified version is that one of the debtor's companies, a special purpose entity formed to pursue commercial real estate development projects, was significantly

in default to its existing secured lender. The debtor and plaintiff met and discussed a short-term loan. According to the plaintiff, the loan proceeds were to be used to fund tenant improvements to attract new lessees to the project. According to the debtor, the proceeds would be used to cure outstanding defaults to the secured lender.

None of the loan proceeds were used for tenant improvements. Rather, the funds were paid to the secured lender to cure the interest arrearage default, which allowed the debtor's entity to obtain a 90-day extension of the maturity date. However, the development did not attract the tenants necessary to keep the project afloat, and the entity defaulted on its obligations to the plaintiff as well as the existing secured lender. The secured lender foreclosed on its mortgage and took ownership of the property. Plaintiff did not participate in the foreclosure.

The BAP explained that generally, exceptions to discharge are narrowly construed against the creditor in order to effectuate the debtor's fresh start. A ruling that a debt is nondischargeable under section 523(a)(2)(A) requires proof that (1) the debtor made a representation; (2) that the debtor knew was false at the time it was made; (3) the representation was deliberately made to deceive the creditor; (4) the creditor justifiably relied on the representation; and (5) the creditor suffered the alleged loss as the proximate result of the representation having been made.

Here, the focus of the bankruptcy court was on one misrepresentation by the debtor: the need for and use of the plaintiff's loan. Weighing the credibility of the witnesses and viewing the evidence in light of the surrounding circumstances, the bankruptcy court found that the debtor told the plaintiff that the loan was needed to fund tenant improvements and not, as the debtor claimed, that the loan would be used to cure outstanding arrearages with the existing secured lender.

In light of the circumstances, the bankruptcy court found this to be the more credible explanation. While the debtor claimed he told the plaintiff that the entity had previously threatened to file bankruptcy, it was not likely that the plaintiff would have made such a loan after that disclosure. Further, it was even less believable that the debtor would have actually made such a disclosure in light of his experience and dire need for the loan. There was no evidence that the debtor had any understanding with his existing secured lender that if the outstanding interest was paid that he could renegotiate that financing in order to repay the plaintiff's loan. And, even the testimony of the debtor's own witness—who was supposedly present when the debtor told plaintiff that the loan would be used to pay the existing secured lender—was afforded no weight because of his involvements with the debtor, and his repeated qualification that his testimony was only "to the best of his recollection." Accordingly,

the BAP found no clear error with the bankruptcy court's determination that the loan proceeds would be used for tenant improvements.

Next, the BAP considered whether the debtor knew the representation was false. The BAP noted nothing in the record indicated clear error on the part of the bankruptcy court in finding that the debtor knew the representation was false. "A creditor may introduce circumstantial evidence to infer a fraudulent intent" and the bankruptcy court found that the debtor had substantial experience from his past role as an investor and board member of a bank, which required his review of loan applications. The debtor knew what lenders needed to evaluate a request for financing, and he knew that the intended use of the loan proceeds was a material consideration. The debtor understood he would need to present the plaintiff with an intended use of the loan proceeds that would demonstrate an ability to repay that loan. The bankruptcy court found that the misrepresentation was intentionally made as part of a "fully-structured story" in order to obtain the loan.

Lastly, the BAP examined the bankruptcy court's finding of justifiable reliance. Justifiable reliance is "an intermediate standard between actual reliance and reasonable reliance" that "depends on the creditor and the facts of the particular case." The BAP noted that reliance is not justified when a creditor "blindly relies upon a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation," but that reliance may still be justifiable "even when an investigation would have revealed the representations' falsity."

Here, the plaintiff relied primarily on the debtor's misrepresentation, which supported the whole proposal, but additionally performed sufficient due diligence prior to extending the loan. Plaintiff conducted a search of the public records and found outstanding property taxes as well as the existing lien, but did not find the existing default. Plaintiff also performed credit checks of the debtor and his wife, and also conducted a site visit to inspect the properties and found them to be "well-managed." The bankruptcy court noted that while the plaintiff could have done more, his failure to do so under the circumstances would not default the justifiability of his reliance. Finding no clear error, the BAP affirmed the decision of the bankruptcy court.

PARTIAL SUMMARY JUDGMENT FROM PRIOR ADVERSARY PROCEEDING MAY HAVE COLLATERAL ESTOPPEL EFFECT

The plaintiff in the Chapter 7 case of *Petters Capital, LLC, Seaver v. Ritchie Special Credit Investments, Ltd. (In re Petters Capital, LLC)*, No. 09-43847-NCD, (Bankr. D. Minn. Dec. 26, 2013) requested that the court stay proceedings in an adversary proceeding based on collateral estoppel because the defendant debtor was

currently in a separate adversary proceeding for similar issues. The bankruptcy court had to determine if collateral estoppel is appropriate to apply to a partial summary judgment order.

The court analyzed the matter under the five-prong test for collateral estoppel established by the Eighth Circuit. The issues in both cases were related to the same issues, and the parties bringing the actions were similar in that one was a lender and one was a secured party. The bankruptcy court also held that because a certification of judgment had been entered, the judgment was final. The court stated that prior precedent in the Eighth Circuit favors the relaxed view of the finality requirement, and that partial summary judgment is a final judgment for collateral estoppel purposes. Because re-litigation of the issues in this case was precluded under collateral estoppel, the bankruptcy court granted the stay, and an order granting partial summary judgment was entered against the debtor in the parallel proceeding.

SUSPECT TIMING AND TERMS OF A DIVORCE DECREE CAN BE A FRAUDULENT TRANSFER, BUT NOT IF DIVISION OF PROPERTY IS CONSISTENT WITH PRENUPTIAL AGREEMENT

In the Chapter 7 case of *Malmberg Development Corporation v. Puro* (*In re Puro)*, Adv. No. 09-3069 (Bankr. D. Minn. Dec. 16, 2013), the plaintiff brought an adversary proceeding asking the bankruptcy court to deny the debtor's discharge under 11 U.S.C 727 (a). The plaintiff asserted several accusations regarding the plaintiff's pre-filing conduct and disclosure on her petition. Part of the plaintiff's argument was calling the debtor's divorce a sham to move assets away from herself, and out of the reach of her creditors, specifically the plaintiff.

As part of a divorce decree, the debtor granted a substantially disproportionate amount of assets to her ex-husband including two parcels of real estate and a luxury SUV. Two years after the divorce, the debtor had not yet transferred title to the SUV pursuant to the divorce decree, but she did not list it on Schedule B of her petition.

The court held that the debtor's discharge should be denied for multiple acts of false oath, inadequacy of financial records, and failure to explain dissipation of assets. However, the plaintiff's arguments under § 727(a)(2)(A) relating to the debtor's diversion of assets away from herself through the divorce decree largely failed. The court stated that, although assets such as the SUV had remained legal property of the debtor, the stipulation in the divorce decree is enough to show that the debtor could have reasonably conceived that it was no longer her property. Further, although timing and terms of the divorce appeared suspect on their face, the division of property was consistent with debtor's prenuptial agreement and the evidence did not indicate that the

couple had built up much wealth over the course of the marriage that would properly be divided as marital property.

A BANKRUPTCY COURT'S INTERPRETATION OF ITS OWN ORDER IS REVIEWED FOR AN ABUSE OF DISCRETION

In *In re Kelley*, 488 B.R. 97 (B.A.P. 8th Cir. 2013), *aff'd*, 536 F. App'x 675 (8th Cir. 2013), the debtors sought relief from a bankruptcy court order requiring them to convey real property to the creditor bank pursuant to an Agreed Order that was incorporated in the debtors' Chapter 11 plan. The Agreed Order stated that the debtors and bank would jointly market the real property in question, and if not sold, that the debtors would "abandon the properties to Centennial Bank." The debtors argued that "abandon" does not mean "convey," and that instead, the bankruptcy court should interpret it as a term of art under 11 U.S.C.A. § 554.

The bankruptcy court disagreed with the debtors, and the BAP affirmed. The BAP stated that "[a] bankruptcy court's interpretation of its own order is reviewed for an abuse of discretion." The BAP stated that the intent of the parties was clear, and the court's analysis was "logical, thorough and supported by the record." Thus, the BAP held that the bankruptcy court did not abuse its discretion by interpreting "abandon to" to mean that the debtors would convey the real property to the bank if not sold. The Eighth Circuit agreed with the BAP's conclusions and found no basis to set aside the bankruptcy court's order.

DEBTOR HAS STANDING TO BRING § 545(2) AVOIDANCE CLAIM WHEN ELEMENTS OF § 522(H) ARE MET

In *McCarthy v. Brevik Law* (*In re McCarthy*) No. 13-6042 (B.A.P. 8th Cir. 2013), a chapter 13 debtor appealed from the judgment of the bankruptcy court dismissing his adversary proceeding seeking to avoid Brevik's statutory attorney fee lien perfected under MINN. STAT. § 481.13 pre-petition against debtor's fully-exempt homestead.

The bankruptcy court held that the debtor lacked authority to exercise the trustee's strong-arm powers under § 545. The BAP reversed and determined that the debtor met the requirements under § 522(h) to establish standing to bring the § 545 action. The debtor had standing under § 522(h) to bring a § 545(2) avoidance action where (1) the transfer of property was involuntary; (2) the debtor did not conceal the property; (3) the trustee did not attempt to avoid the transfer; (4) the debtor sought avoidance under § 522(h); and (5) the transferred property could have been exempted had the trustee avoided the transfer under § 522(g).

DEBTOR LOSES § 523(A)(6) ACTION BY STATE COURT FINDINGS THROUGH COLLATERAL ESTOPPEL WHEN HE TESTIFIED IN THE STATE COURT CASE

In *Phillips v. Phillips* (*In re Phillips*) No. 13-6019 (B.A.P. 8th Cir. 2013), the debtor-defendant filed bankruptcy amid state court litigation against him, several family members and their affiliated entities. The automatic stay barred further action against the debtor as a defendant, but the debtor nonetheless participated as a witness. The state court held that the debtor owned and controlled the affiliated entities which had converted assets owned by the plaintiffs. With these findings, the plaintiffs commenced an adversary proceeding against the debtor seeking to except their claim from discharge under § 523(a)(6).

The bankruptcy court ruled in favor of the plaintiffs. The debtor appealed, asserting that the court erred in giving collateral estoppel effect to the state court judgment entered after the stay. The BAP affirmed the use of collateral estoppel.

The BAP rejected the defendant's argument that collateral estoppel should not apply because he was not a "party" to the state court case. Under Minnesota law, collateral estoppel is available where (1) the issues are identical to those in a prior adjudication; (2) there is a final judgment on the merits; (3) the estopped party was a party or in privity with a party in the previous action; and (4) the estopped party was given a full and fair opportunity to be heard on the adjudicated issues. The BAP affirmed that the debtor participated actively and extensively in the state court trial as a witness and that the debtor asserted ownership of the assets in state court.

The BAP further held that the state court judgment did not violate the defendant's automatic stay because the state court did not enter formally enter judgment against him.

Finally, the BAP determined that the bankruptcy court correctly gave preclusive effect to the state court's determination as to ownership of the assets because a contrary decision would "wholly undermine" the state court's ruling.

MOOTNESS UNDER § 363(M) AND LACK OF APPELLATE STANDING DUE TO SHAREHOLDER STANDING RULE BAR APPEALS OF SALE ORDER

In *Sears v. Badami (In re AFY)*, No. 11-2282 (8th Cir. Oct. 23, 2013), the Eighth Circuit affirmed orders of the U.S. District Court for the District of Nebraska dismissing: (a) the appeal of a sale order due to mootness under 11 U.S.C. § 363(m), and (b) the appeal of an order to pay sale funds and an order converting the case from Chapter 11 to Chapter 7, due to a lack of subject matter jurisdiction resulting from failure to appeal/object and lack of standing.

All appeals were made by two shareholders of the debtor, "individually and on behalf of Sears Cattle." Sears Cattle was a separate corporation that co-owned some of the property sold.

With respect to the appeal of the sale order, appellants admitted that if § 363(m) applied, their appeal was moot, but contended that the district court lacked jurisdiction to hold the appeal was moot because the bankruptcy court lacked subject matter jurisdiction to enter the sale order. The Eighth Circuit found that the district court may dismiss the appeal for mootness regardless of whether the bankruptcy court had subject matter jurisdiction, because mootness is a jurisdictional question and a court faced with multiple jurisdictional issues may decide them in any order.

The appellants also contended that § 363(m) did not moot the appeal of the sale order because (a) the sale was a § 365 sale without assignment of the contract; (b) the sale was not valid under state law; and (c) the buyer was not a good faith purchaser. The Eighth Circuit rejected these arguments, holding that (a) § 363(m) concerns the sale or lease of property, without making any mention of assignment; (b) the state law argument was an impermissible attempt to end-run § 363(m); and (c) § 363(m) expressly applies whether or not the buyer knows of the pendency of the appeal, so the buyer's knowledge of the appellant's appeal did not affect the applicability of § 363(m).

With respect to the appeal of the pay sale funds order, the district court held that Sears Cattle had not objected to the motion and/or had failed to appeal the order because the notice of appeal did not "manifest a clear intent to include" Sears Cattle as a party. The Eighth Circuit found that appellants waived their right to appeal that issue by failing to argue that such finding by the district court was erroneous.

The Eighth Circuit then turned to the standing of the shareholders. The court noted that appellate standing in bankruptcy generally follows the "person aggrieved doctrine," which limits standing to persons with a financial stake in the bankruptcy court's order, "meaning they were directly and adversely affected pecuniarily by the order," a more restrictive standard than the broad right of participation otherwise created by 11 U.S.C. § 1109. The court also acknowledged that the "shareholder standing rule" applies inbankruptcy cases, which prevents shareholders from appealing a bankruptcy court decision in which they assert only a derivative interest. The court concluded that the shareholder standing rule resulted in the shareholders lacking standing to appeal either the pay funds order or the conversion order. Accordingly, the court found that an impact on personal tax liability due to pass-through S-corporation taxation was only an indirect interest, and that the possibility of a surplus to the debtor was also only an indirect interest as to

the shareholders, since any surplus would belong first to the corporation.

CLAIM OBJECTION RESOLVED WITHOUT DISCOVERY; NOVATION DISALLOWED; DISALLOWANCE UNDER § 502(D) DEFERRED

In *In re Polaroid Corp.*, No. 08-46617 (Bankr. D. Minn. Dec. 30, 2013), the bankruptcy court held that a claim objection could be resolved without discovery and on the existing record. The court then partially allowed the claim, determined which estate the claim should be allowed in, and held that the trustee's request for disallowance of the claim pursuant to 11 U.S.C. § 502(d) was premature.

The claimant argued that the court should allow discovery before ruling on the claim objection. The court acknowledged that a claim objection is subject to discovery procedures, but stated that claims are equally subject to disposition on summary judgment. If a party believes it has not had the opportunity to obtain information to justify its position prior to summary judgment, it must show specified reasons why it needs discovery to obtain such information. Here, the court held that the claimant had failed to articulate a reason why the estates would have relevant evidence that was not already in the claimant's possession, A determination of the matter without discovery was appropriate.

As to the claim amount, the court set out the burden of proof standards: that a properly filed proof of claim constitutes prima facie evidence of the validity and amount of the claim, so an objector to the proof of claim bears a burden of production of "substantial" evidence rebutting the claim. If sufficient rebutting evidence is produced, the burden of production shifts back to the claimant, which then must prove its claim by a preponderance of the evidence. The court partially disallowed the claim because the trustee provided sufficient rebutting evidence as to the bulk of the claim and that the claimant had not provided evidence overcoming the trustee's position..

The claimant asserted that the claim should be allowed in the estate of the counterparty to its contract, while the trustee urged that performance under the contract had brought about a novation such that the claim should be against a different estate. For a novation in substitution of parties to be effective, the consent must be explicitly expressed by the original signatories to the contract and the party to be substituted in, and that it must release the original party and the acknowledge the substituted party. The court found that the trustee presented no evidence sufficient to meet this standard. The allowed claim would be against the estate of the original contract counterparty.

Finally, the court addressed the trustee's request for disallowance of the claim pursuant to § 502(d). The trustee and claimant were engaged in

litigation involving preference claims and unpaid royalty claims, and cross-motions for partial summary judgment were pending in that adversary proceeding. The court then held the trustee's request for disallowance was premature, and would be premature until a judgment is entered against the claimant in the adversary proceeding.

EIGHTH CIRCUIT AFFIRMS DECISION REFUSING TO ORDER PAYMENT OF RESTITUTION CLAIM OTHER THAN UNDER APPLICABLE BANKRUPTCY CODE PROVISIONS AND PROCEDURES

In *Lynd v. Ries (In re Genmar Holdings, Inc.)*, No. 13-2127 (8th Cir. Dec. 30, 2013) the Eighth Circuit affirmed an order denying Mr. Lynd's motion for reconsideration of his "restitution claim." The BAP previously held that the relief requested by the appellant was not clear, but that the appellant asserted that the debt purportedly owed to him is not a "claim" to be "included" in the bankruptcy because it is for "restitution." It appeared the appellant wanted an order requiring that his "restitution" claim be immediately paid from some source.

The BAP decision found that restitution claims fall within the Code's definition of "claim," and that any prepetition restitution claim the appellant may have against one of the debtor is "included in the bankruptcy case." The BAP held thatsuch claims remain subject to the asset collection and distribution scheme of the Bankruptcy Code, and that a bankruptcy court may not deviate from the Code to order payment of the claim from some source not authorized by the Code. The Eighth Circuit affirmed.

ANNUITIES OTHER THAN INDIVIDUAL RETIREMENT ANNUITIES MAY BE TAX EXEMPT

In *Running v. Miller*, No. 13-6026 (8th Cir. B.A.P. Nov. 4, 2013), the Bankruptcy Appellate Panel for the Eighth Circuit addressed whether an annuity was tax-exempt under section 408(b) of the Internal Revenue Code, and therefore whether it was exempt property under section 522(b)(3)(C) of the Bankruptcy Code. Several years before filing for bankruptcy, a debtor had used the proceeds of an individual retirement account to purchase an annuity. In order to qualify for favorable tax treatment (and be exempt property) this annuity needed to fit the IRC's definition of an "individual retirement annuity." Under 26 U.S.C. § 408(b), the IRC defines an individual retirement annuity as an annuity contract or endowment contract, issued by an insurance company, which meets certain specified requirements.

The trustee, challenging the debtor's claimed exemption, argued that an annuity purchased with a single, fixed premium cannot satisfy certain of the requirements identified under 26 U.S.C. § 408(b) and therefore cannot

be an "individual retirement annuity." Among other things, the trustee argued that the plain language of the statute requires an individual retirement annuity to have annual premiums. The court disagreed. It interpreted these provisions to mean that annual premiums, if any, may not exceed the specified limitations. It noted that the trustee's interpretation was contrary to the approach taken by commentators, tax planners, and apparently by the IRS.

VALID LIEN CANNOT BE AVOIDED SOLELY BECAUSE SECURED PARTY'S CLAIM IS DISALLOWED AS UNTIMELY

In *Shelton v. Citimortgage, Inc.*, ___ F.3d. ____ (8th Cir. 2013), the Eighth Circuit Court of Appeals held that an otherwise valid lien cannot be avoided solely because the secured party's claim was disallowed as untimely. Citimortgage, which held a lien on the debtors' primary residence, filed a proof of claim after the claims bar date. The claim was disallowed. The debtors then brought an adversary proceeding to have the lien avoided under 11 U.S.C. § 506(d). The Eighth Circuit affirmed the dismissal of the adversary and in so doing, disregarded the plain language of section 11 U.S.C. § 506 of the Bankruptcy Code, which provides in relevant part:

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

Without question, Citimortgage did not hold an allowed secured claim and neither of the exceptions set forth in subsections (d)(1) or (d)(2) applied. But the court elected to look beyond the plain language of the statute for two stated reasons. First, the result advocated by the debtors would be a drastic departure from the "longstanding principle" that liens pass through bankruptcy unaffected. Second, the court was unable to find any justification for avoiding the lien of a creditor who filed a late proof of claim when that same creditor would have kept its lien had it not filed a proof of claim at all. The court implicitly found that the plain language of the statute produced an absurd result – which is an exception to the "plain language" rule of statutory interpretation – and joined the Fourth and Seventh Circuit in holding that a lien underlying a disallowed claim survives bankruptcy if the sole basis for disallowance is untimeliness.

SHAREHOLDER STANDING RULE DOES NOT APPLY IN A BANKRUPTCY APPEAL WHEN INJURY IS INDIRECT AND BASED ONLY ON STATUS AS SHAREHOLDER OF A CORPORATION

In the case of *Ainsworth Feed Yards Company, Inc. v. Sears (In re AFY)*, No. 12-1305 (8th Cir. Oct. 23, 2013), the bankruptcy court and the BAP denied AFY shareholders' objections to claims against AFY's estate, and the Eighth Circuit dismissed the shareholders' appeal for lack of standing.

AFY filed for Chapter 11 bankruptcy, and the Trustee approved payment to prior owners for the purchase price of stock they sold pursuant to an Agreement with AFY. The current AFY shareholders—Appellants—asserted that AFY was not the liable party under the Agreement; thus, they denied the claim against the AFY estate. AFY, the only party directly affected by the bankruptcy court's order allowing the claims, is not a party to the appeal.

Appellate standing in bankruptcy cases is stricter than Article III standing. Only persons that were directly and adversely affected by a bankruptcy court's order have standing under the person-aggrieved doctrine. Indirect injury, based only on status as a shareholder, is insufficient to establish standing for a bankruptcy appeal because corporations are entities separate from their shareholders. Appellants' claim, that their distributions as shareholders will be affected if AFY's estate pays these contested claims to the former owners, is an example of an indirect-shareholder injury that the Eighth Circuit rejects for standing purposes.

The Eighth Circuit acknowledged an exception to this shareholder standing rule when management, or a trustee, acts in bad faith when settling the estate. The AFY shareholders argued that the Trustee acted in bad faith because its interests were allied with AFY; however, they failed to offer sufficient evidence to demonstrate this purported bad faith.

The court concluded that the AFY shareholders lacked standing to appeal the bankruptcy court's order; thus, it did not reach the merits of their appeal.

IF GARNISHEE RETAINS LESS THAN $600.00 OF A GARNISHED AMOUNT, THE AFFIRMATIVE DEFENSE UNDER § 547(c)(8) APPLIES

In *Pierce v. Collection Associates, Inc. (In re Pierce)*, 13-6048 (8th Cir. BAP), the Bankruptcy Appellate Panel for the Eight Circuit held that, in a preference case involving the garnishment of a debtor's wages, the affirmative defense set forth under 11 U.S.C. § 547(c)(8) relates to the dollar amount *retained* by a garnishee as opposed to the dollar amount *garnished* when part of the garnished amount was already returned to the debtor.

11 U.S.C. § 548(c)(8) provides that "(c) a trustee many not avoid under this section a transfer- (8) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $600." In the Pierce case, the defendant obtained a judgment against the debtor and garnished the debtor's employment wages. The total dollar amount garnished was $858.98. Under Nebraska law, however, "wages withheld by a garnishee must first be transferred to the court for delivery to the judgment creditor." At the time of the debtor's bankruptcy filing, the defendant had received $562.78 in four garnishments. After the debtor's bankruptcy filing, two additional checks of $148.10 each were received by the Nebraska State Court from the garnishee. The two checks were provided to the garnishee, but the garnishee subsequently returned the two checks to the debtor due to the intervening bankruptcy filing.

The debtor brought a preference avoidance action against the garnishee for the full $858.98 garnished. The parties agreed that the elements of a preference under 11 U.S.C. § 547(b) were met, but the garnishee argued that because the last two transfers that were garnished were never paid to the garnishee, the defense under 11 U.S.C. § 547(c)(8) should apply.

The court held that "at one time all six wage garnishments, totaling $858.98, constituted preferences… [as] for preference purposes, if the property transferred is the debtor's wages then the transfer occurs precisely when wages are earned." The court further noted, however, that by the time the preference claim was asserted, the two last transfers had already been returned to the debtor. As a result, because the total amount sought by the estate was less than $600.00, the defense under 11 U.S.C. § 547(c)(8) applied.

DEBTORS MUST INCLUDE ALL INCOME RELATING TO THE STATUTORY SIX MONTH PERIOD IN THEIR CURRENT MONTHLY INCOME WHETHER OR NOT IT WAS RECEIVED AND DEBTORS COULD NOT DEDUCT A WAGE GARNISHMENT BY A CREDITOR AS AN EXPENSE ON THEIR MEANS TEST

In the Chapter 7 case of *In re Strickland*, No. 13-42840, there were three issues before the U.S. Bankruptcy Court for the District of Minnesota on the United States Trustee's Motion to Dismiss based on the presumption of abuse in 11 U.S.C. § 707(b)(2): (i) whether the debtors' current monthly income for purposes of the means test included income that had been earned during the statutory six month period, even it had not been received during that same period; (ii) whether the debtors could deduct a pre-petition wage garnishment as an expense on their means test; and (iii) whether the debtors' student loan payment could be deducted as a "special circumstance" on the means test.

With respect to the first issue, the bankruptcy court held that "current monthly income" included any income derived during the six month period regardless of whether the debtor had received the income during that same time. Therefore, any income derived during the statutory six month period was to be included in the CMI calculation of income on the debtors' means test.

On the second issue, the court held that since the pre-petition wage garnishment would no longer be in effect upon the date of the filing due to the automatic stay, the debtors could not deduct it as an expense from their Means Test since it would not then be an "actual monthly expense" as required by § 707(b)(2)(A)(ii)(I).

Lastly, the court held that it need not reach the issue of whether or not student loan payments could be considered as "special circumstances" such that the presumption of abuse could be rebutted because once the debtors' Means Test was adjusted to include all income derived during the six month statutory period and to exclude the pre-petition garnishment, the presumption of abuse could not be overcome even if the student loan payments were included as a special circumstance.

DEBTOR COULD NOT EXEMPT REAL PROPERTY HE OWNED BUT DID NOT LIVE IN AND HAD NO INTENTION OF RETURNING TO IN THE FUTURE

In the case of *William NMI Paul, Jr. vs. Forrest C. Allred, (In re Paul)*, No. 13-1747, the Eighth Circuit Court of Appeals affirmed the entry of Summary Judgment in favor of a Chapter 7 Trustee who objected to a debtor's homestead exemption under South Dakota law.

In his schedules, the debtor listed a parcel of real property he owned and exempted it under South Dakota's homestead exemption. He then testified at his meeting of creditors that he had moved out of the property fourteen or fifteen years prior and currently rented the property to tenants. He also testified that he had no intention to move back into the property.

The trustee objected to the debtor's exemption of the property under South Dakota's homestead exemption on the basis that the debtor did not intend to live at the property at any point in the future. The debtor did not contest any facts as they were presented by the trustee, but instead challenged the trustee's characterization of the homestead exemption. The trustee then moved for summary judgment on the pleadings. The bankruptcy court granted summary judgment in favor of the trustee on the basis that the debtor could not apply the South Dakota

homestead exemption to the property when he had no "present intent to return" to it. The BAP affirmed the bankruptcy court's decision.

On appeal to the Eighth Circuit Court of Appeals, the debtor made the following arguments in an attempt to re-characterize South Dakota's homestead exemption: (i) he reserved the right to return to the property should his recent marriage run into any discord; (ii) he could, at any time, chose to move out of his wife's home and into the property; and (iii) he should not be deprived of the property rights of a single person simply by virtue of the fact that he got married. The court rejected these arguments and affirmed the bankruptcy court and the BAP's decisions, holding that South Dakota law required that the party who ceased to occupy the property have some intention to return to the property at some point in the future. Since the debtor's testimony at his meeting of creditors clearly showed that he had no intent to live at the property at any point in the future, the homestead exemption could not be used to protect the property.

DENIAL OF RELIEF FROM STAY AND DENIAL OF REQUEST TO ABSTAIN ARE NOT ABUSES OF DISCRETION WHEN MOVANT'S CLAIMS ARE ALL DISCHARGEABLE DEBTS

In *Chae v. Bennett (In re Bennett)*, No. 13-6041, (B.A.P. 8th Cir.), the Bankruptcy Appellate Panel for the Eight Circuit Court of Appeals affirmed the bankruptcy court's denial of relief from stay and granting of a motion to abstain where all of the claims at issue were subject to the discharge order.

Prior to the commencement of the bankruptcy case, Bong H. Chae had filed an action in state court against the debtor, alleging malpractice, negligence, and fraud. The state court action was subject to the automatic stay when the debtor filed the petition commencing her case.

Mr. Chae filed motions for relief from the automatic stay and for abstention and remand. The hearing on Mr. Chae's motions was then continued on his request to June 17, 2013, by which time the discharge order had already been issued and the deadline had passed for filing an objection to the dischargeability of claims. After the hearing, the bankruptcy court denied Mr. Chae's motions and rendered findings of fact and conclusions of law from the bench.

The BAP found that the bankruptcy court did not abuse its discretion by denying relief from the automatic stay because "there was no purpose for granting stay relief since the malpractice and negligence actions were dischargeable debts, and the fraud claim was discharged when Mr. Chae failed to file an adversary proceeding by the deadline to do so." Additionally, the BAP found that the motion for relief from stay was correctly denied because the stay had already terminated when the discharge order was issued.

The BAP also found that the bankruptcy court did not abuse its discretion by denying the motion for abstention because the discharge meant that there were no claims from which the bankruptcy court could abstain. Even if the claims had not been discharged, the BAP found that there was nothing to abstain from because the claims had never been removed from state court to the bankruptcy court.

ORDER APPROVING A STIPULATION IS NOT BASIS FOR CONTEMPT UNLESS IT ADOPTS THE STIPULATION'S TERMS, STATES THAT IT IS ENFORCEABLE BY CONTEMPT, AND IS OTHERWISE CLEAR AND UNAMBIGUOUS

In *Fischer v. Great Western Bank (In re Fischer Farms)*, No. 13-6043, (B.A.P. 8th Cir.), the Bankruptcy Appellate Panel for the Eight Circuit Court of Appeals affirmed the bankruptcy court's denial of a motion for contempt and reiterated the Eighth Circuit's high standard for findings of contempt.

The debtors were family farmers. Great Western Bank held a perfected security interest in the debtors' crops, farm products, and livestock. Pursuant to the debtors' confirmed chapter 12 plan, they were required to pay all real estate taxes assessed against their property, including delinquent taxes. When the debtors failed to pay their real estate taxes, Great Western Bank filed a motion to compel the debtors to pay their delinquent real estate taxes in order to protect the bank's collateral.

The debtors and the bank resolved the motion to compel through a stipulation requiring the debtors to liquidate their cattle, distribute the proceeds in a specific manner, and file affidavits of compliance. Once the debtors fulfilled their obligations under the stipulation, the bank was to release its security interest in the crops and livestock. The stipulation was approved by the bankruptcy court in a text order that substantially said, "[t]he stipulation is approved, except for paragraph 7(a) and (b)."

After the debtors fulfilled their requirements under the stipulation, Great Western Bank did not immediately release its lien. The debtors applied for a loan from another bank, but their application was denied because Great Western Bank's lien had not yet been released. The debtors then notified Great Western Bank that the lien had not been released, and the bank filed an amended UCC financing statement releasing the lien.

The Fischers then filed a motion requesting that the bank be found in contempt. The bankruptcy court denied the motion because the bank was not required to release the lien within a specific time frame and the bank's actions did not rise to the level of contempt.

The BAP restated the high standard for finding contempt only where a clear court order exists that can properly be enforced. The BAP found that the order approving the stipulation was ambiguous and "did not impose any operative commands or express prohibitions." Instead, the order merely recited an abstract legal conclusion that the stipulation was approved without requiring or prohibiting action by either party. The BAP further found that even if the order had included language clearly requiring or prohibiting compliance with the stipulation, a finding of contempt would not be available because the stipulation was ambiguous about the time structure for when the bank was required to release the lien. Since the bank did release the lien, it was deemed to be in compliance with the stipulation.

DISCHARGE DOES NOT PRECLUDE ENFORCEMENT OF MORTGAGE INTEREST

In *Pennington-Thurman v. Bank of America, N.A.*, 13-6023, the Bankruptcy Appellate Panel for the Eighth Circuit Court of Appeals affirmed the denial of a debtor's motion to reopen her personal bankruptcy case for the purpose of pursuing an alleged violation of the discharge injunction by her mortgagee.

The debtor filed a motion to reopen her case about 15 months after her personal bankruptcy case was closed. She claimed that each of the mortgage foreclosure-related notices that she received from the mortgagee constituted an effort to collect a discharged debt.

The bankruptcy court rejected the debtor's underlying claims, explaining that the enforcement of a mortgage against real estate does not constitute an attempt to collect a debt as a personal obligation of the debtor. The BAP agreed, stating that a personal liability may be discharged, but the discharge in bankruptcy does not operate to extinguish a creditor's *in rem* rights to foreclose against property in which it holds a valid lien.

Under Section 350(b) of the Bankruptcy Code, a bankruptcy case may be reopened only to administer assets, accord relief to the debtor, or for other cause. Because the bankruptcy court determined that the debtor's claims lacked merit, it held that cause to reopen the case did not exist. The BAP affirmed such decision, holding that it did not constitute an abuse of discretion.

UNDISCLOSED EQUITABLE INTEREST IN REAL PROPERTY RESULTS IN A REVOKED DISCHARGE

In *Johnson v. Johnson*, 13-1034 (8th Cir.), the Eighth Circuit Court of Appeals revoked discharges of two debtors pursuant to 11 U.S.C. §727(d)(1) due to their failure to disclose their continued equitable interest in real property.

Two months prior to filing

bankruptcy, the debtors attempted to convey their lake property to their parents. After the conveyance, the debtors' personal property remained at the lake property, the debtors continued to use and enjoy the lake property, and the debtors funded utilities, property taxes, and improvements relating to the lake property. Under the terms of the agreement purporting to transfer the lake property, the debtors agreed to pay back their parents the entire purchase price, plus interest, at which point the debtors would again own the lake property entirely.

Based on the foregoing, the court found that an equitable mortgage existed and debtors maintained an ownership interest in the lake property. The court found that the entire transaction was a sham and the transfer was accomplished with intent to defraud creditors. The debtors' fraudulent transfer of the lake property cost them a discharge in bankruptcy.

The court made the additional finding that the debtors fraudulently made a false oath or account on their bankruptcy schedules by failing to schedule any interest in the lake Property. Accordingly, a revocation of discharge was further supported by §727(a)(4)(A).

PRE-PETITION JUDGMENT ENFORCEABLE FOR NON-DISCHARGEABLE, POST-PETITION DEBT

In *Smith v. Missouri*, 13-1769, (8th Cir.), the Eighth Circuit Court of Appeals denied a debtor's motion for contempt in connection with a creditor's alleged violation of the discharge injunction.

The debtor was incarcerated at a Missouri Correctional facility. Prior to the debtor's bankruptcy filing, the State of Missouri obtained a judgment against the debtor for the costs of incarceration incurred through his final release. After the debtor received a discharge, the Inmate Treasurer directed that $45.00 be withdrawn from the debtor's account for post-petition costs, and that such amount be paid to the State pursuant to the judgment.

The debtor filed a motion for contempt alleging that the State violated his discharge through these collection efforts. In denying the debtor's motion for contempt, the court held there was no violation of the discharge order, because the law does not provide for discharge of future debts. The court held that the judgment was valid as to future reimbursement of the debtor's incarceration costs.