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Trustee Lacks Standing to Seek Avoidance of Transfers Made by Non-Debtor If No Creditor of Debtor Could Have Done So Outside of Bankruptcy

In *Stoebner v. Opportunity Finance, LLC (In re Polaroid Corporation),* 543 B.R. 888 (Bankr. D. Minn. 2016), the bankruptcy court addressed whether the trustee sufficiently pleaded facts to establish standing to assert claims under 11 U.S.C. § 544(b) and the Minnesota Uniform Fraudulent Transfer Act ("MUFTA") to avoid payments made by a non-debtor entity to its lenders. The bankruptcy court granted the defendant lenders' motion to dismiss the trustee's claims with prejudice, holding that: (i) the trustee does not have standing to avoid payments made by a non-debtor entity to its lender if there is no specific creditor of the debtor from whom such right could be derived; and (ii) even if the trustee had standing to bring his avoidance claims, the trustee's claims fail because the Ponzi scheme presumption upon which the trustee relies was rejected by the Minnesota Supreme Court in *Finn v. Alliance Bank.*

The trustee sought in his complaint to avoid payments made by non-debtor entities to lenders under 11 U.S.C. § 544(b) and MUFTA. After several rounds of motion practice, and attempts by the trustee to correct pleading deficiencies, the lenders moved the court to dismiss the trustee's claims, because, among other reasons, (i) the trustee lacked standing to avoid transfers made by Petters CB Funding, an entity separate and distinct from the debtor, and (ii) the payments were not avoidable because reasonably equivalent value was furnished by antecedent secured debt.

The court explained that the trustee's right to avoid transfers under § 544(b) must "derive from the right of a specific creditor of the debtor that is in bankruptcy in the case from which a particular avoidance proceeding is sued." Such a claim must be allowable and enable its holder to receive a distribution from the bankruptcy estate; "allowability rests on a pre-petition legal enforceability 'against the debtor and property of the debtor.'" The trustee pleaded that a creditor existed with respect to PettersCB, but continued by listing creditors of the debtor. The court surmised that the Trustee was arguing that the debtor was somehow a successor in interest to PettersCB. However, the court found the trustee's amended complaint lacking in any facts supporting such a relationship because all of the transfers occurred before Petters acquired any interest in the debtor. As a result, the court held that "there is no basis in the trustee's present fact-pleading on which to accord him statutory standing to sue the defendants on transfers they received from PettersCB." The court applied the same reasoning to a prepayment penalty the trustee sought to recover from one of the lenders.

Standing aside, the court held that the trustee's claims fail on substantive grounds because the Minnesota Supreme Court, in *Finn v. Alliance Bank,* rejected the Ponzi scheme presumption as a way to establish elements of claims under MUFTA. The bankruptcy court found that without the presumption, the trustee failed to plead facts supporting the occurrence of actual fraud involved in the subject transfers, or any allegations addressing the "badges" of fraud described under MUFTA; "[n]ot a single pleaded fact goes to how PettersCB would have paid [the lender] with a contemporaneous intent to hinder, delay, or defraud *its own* creditors."

With respect to constructive fraud, the court found that without the ability to rely upon the Ponzi scheme presumption, the trustee failed to plead any facts related to whether the transfer was for reasonably equivalent value. The court rejected the trustee's argument that reasonably equivalent value was lacking because the business model of PettersCB was unsustainable.

In addition, the trustee's claims under MUFTA failed because the trustee's factual allegations were contrary to the requirements of both his actual fraud and constructive fraud claims. The court began by reiterating the law that even under the "original federal framing [of the Ponzi scheme presumption], only payments made by a perpetrator 'in furtherance of the scheme,' are subject to avoidance." In addition, the court recounted the reasoning provided in *Finn* that MUFTA requires an "'asset-by-asset and transfer-by-transfer'" analysis as to each transfer and requires proof of each element. As a result, the court rejected the trustee's argument because the trustee alleged that the transactions involving PettersCB were engaged in to acquire actual goods with borrowed money. The trustee did not allege that the proceeds of these transactions were used in furtherance of the Ponzi scheme perpetrated by Petters, or that the lender acquired ill-gotten gains from the scheme.

Case Converted from Chapter 13 to 7 and Stay Pending Appeal Denied After Lengthy History of Dishonesty

In *In re Paul Hansmeier*, Bankr. Case No. 15-42460, the bankruptcy court denied the debtor's motion for stay pending appeal of the conversion of his case from chapter 13 to chapter 7. In its decision, the court examined the following four factors: (1) the likelihood of success on the merits of the appeal; (2) the risk that the moving party would suffer irreparable injury if stay were not granted; (3) whether substantive harm would come to other interested parties; and (4) the public interest. Existing case law permits the court to give additional weight to the first two factors, but ultimately, a debtor must prove all four factors to obtain stay pending appeal. In this case, the court found that all four factors supported denial of his motion.

The debtor's case was converted for cause under § 1307(c) after the court found the debtor had engaged in an extensive pattern of pre- and post-petition dishonest acts. For example, prior to filing, courts in several jurisdictions found the debtor had engaged in actual fraud and/or sanctionable conduct. During the pendency of his case, he willfully misrepresented his assets and expenses on his schedules, the trustee discovered the pending sale of his $1.2 million-dollar home only through an internet search, he dissipated over $80,000 in assets (including funds from his lawyer trust account), and repeatedly refused to follow court orders. The court also found the attorney was subject to disciplinary proceedings and the pending revocation of his license to practice law would make his chapter 13 plan unfeasible.

Chapter 12 Debtor May Exempt Farm Proceeds as Earnings Under Minnesota Law

In *In re Darin Larry Seifert*, Bankr. Case No. 13-60831, the debtor was permitted to claim an exemption in sale proceeds of his annual crop. Under Minn. Stat. § 550.37, a debtor may exempt "all earnings not subject to garnishment." Additionally, the Minnesota statute defines "earnings" to include "compensation paid or payable to the producer for the sale of agricultural products . . . produced when the producer is operating a family farm . . . .” Accordingly, if a debtor-farmer sells his or her own crops, the proceeds of such a sale constitute the debtor’s “earnings” for such crop year, notwithstanding the fact that “earnings from agricultural products do not track a typical wage-earner’s pay period.”

The bankruptcy court next considered the appropriate amount of a farmer-debtor’s exemption under Minnesota law. Minn. Stat. § 550.37(a) does not allow 100 percent of a debtor’s earning to be exempt; rather, only the portion of the debtor’s earnings that are not subject to garnishment are exempt. The method for calculating the amount subject to garnishment is the lesser of the amounts set forth in subsections (a)(1) vs. (a)(2). For the purpose of making such calculation, the Court noted that a farmer’s pay period is based on a 52-week year because farmers generally work all year long for a single pay day.

The Right to Interest is Not Waived by not Requesting it When Filing a Motion for Summary Judgment.

In *Stoebner v. PNY Technologies, Inc. (In re Polaroid Corp. et al.),* 529 B.R. 887 (Bankr. D. Minn. 2013), the bankruptcy court recommended to the district court that interest and attorney’s fees in addition to damages should be awarded to the trustee after application of setoff of defendant’s claims against the estate.

Defendant filed a claim against the estate. The trustee initiated an adversary proceeding as a core-proceeding under 28 U.S.C. § 157(b)(2)(C) (“counterclaims by the estate against persons filing claims against the estate”). However the amount of the recovery sought by the trustee exceeded the amount of the claim asserted by defendant, thus potentially resulting in a positive recovery to the estate. “Thus Article III’s constitutional limitations barred the treatment of [the claim] as a core proceeding notwithstanding its nominal match to the statutory category.” As a result, the bankruptcy court lacked authority to enter final judgment unless the parties consented, which defendant refused to do.

After procedural maneuvering, the matter was referred to the district court and sent back to the bankruptcy court for consideration of whether interest could be awarded, whether attorney’s fees could be awarded, and how setoff should be applied.

The underlying contract between the parties provides that “[i]n addition to monies due under this Agreement, [defendant] will pay to Polaroid one percent (1%) per month or the highest rate permitted by applicable law (whichever is less) on all amounts that are not paid when due.” The court determined that total interest of $416,961.63 was due under this calculation. The defendant opposed the award of interest on several grounds including that the request for interest was not made when the initial motion for summary judgment was made. The court determined that this did not constitute waiver of interest, in part because applicable state law provides that interest shall be added after determination of the amount of principal due. The court further noted that even if state law did not apply, a district court judge has the authority to modify findings and rulings proposed by a non-Article III judge, and may do so on his own motion.

The underlying contract between the parties provides that “In addition, [defendant] will pay to Polaroid all of Polaroid’s costs of collecting and enforcing the terms and provisions of this Agreement (including without [sic] limitation, attorneys' fees and costs)." Defendant opposed the award of attorney's fees based on an accusation of unclean hands by the trustee and that the fees were excessive compared to the amount of recovery. The court denied both of these arguments in awarding attorneys' fees, finding that the fees were necessary to recovery and that PNY failed to cite any instance of misconduct on the part of the trustee in prosecuting the claims.

The court allowed for setoff of defendant's claims against the estate, recommending that the district court enter an order giving the estate judgment in the net amount of the asserted claims, plus interest, plus attorneys' fees, net of the amount of defendant's claim.

Failure to Disclose a Claim Belonging to a Debtor in a Bankruptcy Filing May Make the Claim Subject to Judicial Estoppel

In *Jones v. Bob Evans Farms, Inc.*, 811 F.3d 1030 (8th Cir. 2016), the Eighth Circuit held that failure to disclose a potential legal claim may result in judicial estoppel if the debtor tries to pursue the claim in a separate action.

The debtor began working for defendant in June of 2009. Shortly thereafter, he filed a voluntary petition under chapter 13. A plan was confirmed in early 2010. The confirmation order, amongst other things, required the debtor to disclose any events affecting disposable income including lawsuits "received or receivable" during the term of the plan which would not exceed five years. Debtor quit his job in 2012 and subsequently filed a charge of employment discrimination with the EEOC. Upon receiving a right to sue letter from the EEOC, debtor filed a lawsuit against defendant in state court. The lawsuit was eventually removed to federal district court. In July of 2014, the bankruptcy court granted a discharge of $146,499.58 of unsecured debt. The district court dismissed the employment discrimination lawsuit, concluding that debtor was judicially estopped from pursuing the claim. Debtor filed a motion with the bankruptcy court to reopen the bankruptcy case, which was granted, and amended his schedules to include the claim. Debtor subsequently filed a motion with the district court requesting that it amend its prior order; however, the court denied the motion, finding that judicial estoppel still applied to the claim.

In reviewing the lower court's conclusions, the Eighth Circuit noted that judicial estoppel is an equitable doctrine that "prevents a party from asserting a claim in a legal proceeding that is inconsistent with a claim taken by that party in a previous proceeding." The circuit court noted that although there is no bright line test for determining when judicial estoppel applies, there are three factors: (1) whether a party's later position is 'clearly inconsistent' with its prior position; (2) whether a party has persuaded a court to accept its prior position so that judicial acceptance of an inconsistent position in a later proceeding would create the perception that either the first or second court was mislead; and (3) whether the party asserting inconsistent positions would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped.

In examining the factors, the Eighth Circuit found that debtor's positions between his bankruptcy case and discrimination case were clearly inconsistent. It further found that "[debtor's] failure to amend his bankruptcy schedules to include his discrimination claims 'represented to the bankruptcy court that no such claims existed,' and his assertion of those claims in this case is inconsistent with that prior position."

With regard to the second factor, the circuit court found that because the bankruptcy court discharged the debtor's unsecured debts, it adopted debtor's position that the discrimination claims did not exist. Although the debtor moved to reopen the bankruptcy case and amended his bankruptcy schedules, the "court's original discharge of the debt is sufficient acceptance of the debtor's position to provide a basis for judicial estoppel."

With regard to the third factor, the Eight Circuit found that judicial estoppel was appropriate "because [debtor] could have derived an unfair advantage in the bankruptcy proceedings by concealing his claims . . .'[J]udicial estoppel does not require that the nondisclosure must lead to a different result in the bankruptcy proceedings,' however, and may apply based on a litigant's intent to mislead the court."

Term "Actual Fraud" in § 523(A)(2)(A) Can Include Fraudulent Conveyance Schemes and Other Forms of Fraud Without a False Representation

In *Husky Int'l Elecs., Inc. v. Ritz (In re Ritz)*, 578 U.S. __, 136 S. Ct. 1581 (2016), the Supreme Court reversed the decision of the Fifth Circuit that a necessary element of "actual fraud" is a misrepresentation by the debtor to a creditor. The Fifth Circuit had affirmed the district court, which had affirmed in part and reversed in part the decision of the bankruptcy court. The Supreme Court's holding means that a debt obtained through a fraudulent conveyance scheme may, under some facts, be excepted from discharge under § 523(a)(2)(A).

In the instant case, the undisputed facts are that (1) the creditor sold products to Chrysalis Manufacturing Corp., thereby creating a debt of $163,999.38; (2) the debtor was a director and major shareholder of Chrysalis; and (3) between 2006 and 2007, the debtor drained Chrysalis of assets by transferring funds to other entities under his control. In May 2009, the creditor sued the debtor under a Texas statute that holds shareholders responsible for corporate debt in the case of "actual fraud." After the debtor filed a chapter 7 petition, Husky filed a complaint again seeking a determination of personal liability under the Texas statute and also seeking a determination that the obligation should be excepted from the discharge by operation of 11 U.S.C. § 523(a)(2)(A), among other allegations.

The bankruptcy court held that there was no personal liability under the Texas statute because there were no false representations upon which the creditor relied and, because there was no personal liability, there was no obligation to be excepted from discharge. The district court reversed in part by finding that the fraudulent conveyance scheme was accompanied by sufficient badges of fraud to establish intent to commit actual fraud under the Texas statute such that the debtor should be held personally liable. The district court affirmed in part by finding that the fraudulent conveyance did not qualify as actual fraud for purposes of 11 U.S.C. § 523(a)(2)(A) in the absence of a false representation. The Fifth Circuit affirmed, "conclud[ing] that a representation is a necessary prerequisite for a showing of 'actual fraud' under Section 523(a)(2)(A)." 787 F.3d 312, 321 (5th Cir. 2015).

In reversing the Fifth Circuit, the majority noted that before 1978 the fraud exception to discharge was phrased to include only debts obtained by "false pretenses or false representations" and that the phrase "or actual fraud" was added in 1978. Under the canon of statutory construction that the wording of an amendment should be interpreted to have "real and substantial effect," the Court concluded that "actual fraud" cannot mean the same thing as "a false representation."

The majority dismissed the debtor's argument that interpreting "actual fraud" to include fraudulent conveyances would render § 523(a)(2)(A) duplicative of §§ 523(a)(4) and (a)(6) by noting that there has always been some potential overlap between the subsections and that they still have meaningful distinctions that will result in some debts being excepted from discharge by one subsection that would not be covered by the others. The majority also dismissed the debtor's argument that this interpretation would create redundancies between §§ 523(a)(2)(A) and 727(a)(2) by noting that the two provisions are distinct in terms of scope and timing.

The debtor and the dissent (Thomas, J.) both note that § 523(a)(2)(A) refers to "any debt . . . to the extent *obtained by* . . . false pretenses, a false representation, or actual fraud" (emphasis added) and argue that "obtained by" requires a causal nexus that does not exist in most fraudulent conveyances. That is, a fraudulent conveyance is not an activity by which a debt is usually "obtained." The majority dismisses this argument by noting that the recipient of the transfer can "obtain" assets by the transfer and subsequently have a debt that would be excepted from discharge if the transferee later files a bankruptcy petition.

The dissent criticizes the majority's argument that "actual fraud" must mean something other than "false representation" if all words in the statute are to be given effect. Justice Thomas notes that under the majority's interpretation, "actual fraud" is broader than and subsumes both "false pretenses" and "false representation." Justice Thomas argues that the canon against surplusage should not be applied where, as here, no interpretation gives effect to every clause and word of the statute.

Bankruptcy Court has Discretion to Reconvert Case Notwithstanding Language In § 706(A), But Only If Reconversion Is In Good Faith And Feasible

In *In re Dahl*, Bankr. Case No. 14-60024, (Bankr. D. Minn. Jan. 8, 2016), the bankruptcy court held that a debtor who initially filed a petition under chapter 13 and voluntarily converted the case to one under chapter 7 may be allowed, in the court's discretion, to reconvert the case to one under chapter 13 notwithstanding the language of 11 U.S.C. § 706(a), but only if the debtor demonstrates that the reconversion is in good faith and that the prospective chapter 13 plan is feasible.

Section 726(a) states: "[t]he debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title." The court noted that there is a split of authority about whether this language acts as a prohibition on reconversion or if courts have discretion to allow reconversion under appropriate circumstances. The court agreed with the reasoning in cases that point out that § 706(a) restricts the debtor's right to reconvert, but says nothing about the court's authority to order reconversion. It further agreed with the line of cases holding that the silence as to the court's authority means that the court has discretion to allow reconversion with the ultimate burden of proof on the issues of good faith and feasibility of the chapter 13 plan falling on the debtors. In this particular case, there was a significant budget deficit in the debtors' amended Schedules I and J; therefore, the debtors failed to satisfy their burden of proof that the chapter 13 plan would be feasible.

Bankruptcy Court Holds Inmate's "Pay to Stay" Debt Is Dischargeable

In *County of Dakota v. Milan (In re Milan),* 546 B.R. 187 (Bankr. D. Minn. 2016), the bankruptcy court held, in a matter of first impression, that costs charged to an inmate pursuant to Minnesota's "pay to stay" program are dischargeable. Minnesota law authorizes counties to assess inmates for costs such as room, board and medical care while incarcerated. Minn. Stat. § 641.12. Dakota County Sheriff's Office ("DCSO") exercises this authority and bills inmates for a portion of the cost incurred by the county to house and care for them. The debtor was incarcerated for 179 days between January 2006 and November 2012 and was charged by DCSO $3,583.00 for room and board and $22.43 for medical expenses. After he and his spouse received a chapter 7 discharge, the county sought a determination that the debt was excepted from the discharge by 11 U.S.C. § 523(a)(7), which applies to a debt that is "a fine, penalty, or forfeiture; payable to and for the benefit of a governmental unit; and is not compensation for actual pecuniary loss. . . ." The bankruptcy court determined that the debt was not dischargeable because it was not penal in nature, was not the result of a court order or judicial act, and was explicitly intended to reimburse the county for actual pecuniary loss associated with the incarceration.

Eighth Circuit Affirms Dischargeability of Inmate "Pay to Stay" Debt

In *County of Dakota v. Milan (In re Milan),* 556 B.R. 922 (8th Cir. 2016), the Eighth Circuit affirmed the bankruptcy court's determination that costs charged to an inmate pursuant to Minnesota's "pay to stay" program are dischargeable.

The Eighth Circuit reasoned that to be excepted from discharge under § 523(a)(7), a debt must be penal in nature. A punitive or rehabilitative governmental aim may be shown in the content of a court order, or through statutory or regulatory language that indicates intent to punish a debtor. Looking at an internal policy statement and the remedies available to collect the debt, the appeals court held that the debt was dischargeable because it was pecuniary and not penal in nature.

A Non-Frivolous Appeal is Not a Further Violation of The Discharge Injunction

Having successfully defended a collection lawsuit by obtaining a ruling from the Eighth Circuit that the plaintiff violated the discharge injunction, the defendant then sought an award of his attorneys' fees and costs incurred in bankruptcy court, district court and the Eighth Circuit. In *Venture Bank v. Lapides*, Adv. No. 11-04227 (Bankr. D. Minn. Jan. 7. 2016), the bankruptcy court awarded the fees and costs incurred during the adversary proceeding before the bankruptcy court as a sanction for violating the discharge injunction, but refused to award fees and costs incurred during the appeals. The bankruptcy court held that a non-frivolous appeal of an order finding a violation of the discharge injunction is not a further violation of the discharge injunction. A contrary rule, the court reasoned, would interfere with a litigant's right to appeal an adverse ruling. The bankruptcy court further held that a trial court lacks the authority to impose sanctions for an appellant's behavior, as such authority belongs to the appellate court.

Eighth Circuit Rules That Debtor Can Avoid Inchoate Liens Under § 522(f)(1)(A).

In *CRP Holdings, A-1, LLC v. O'Sullivan (In re O'Sullivan*), 544 B.R. 407 (B.A.P. 8th Cir. 2016) (vacated and remanded by *In re O'Sullivan*, No. 16-1526, 2016 WL 6677837 (8th Cir. Nov. 14, 2016)), the debtor claimed an exemption in a residence owned as tenants by the entirety with his non-filing spouse. At issue was a purported judgment creditor's lien on the residence. The debtor moved to avoid the lien under § 522(f)(1)(A). The creditor objected, arguing that the lien did not attach to the residence because the judgment did not extend to his spouse—the other tenant by the entirety. The bankruptcy court granted the debtor's motion. The creditor appealed.

The BAP reasoned that the use of the non-technical term "fixed" in § 522(f) indicated that both choate (or perfected) liens and inchoate loans were eligible for avoidance. The BAP proceeded with avoidance analysis, noting that the lien was, at best, unenforceable—noting doubts that a lien existed at all.

On appeal, the Eighth Circuit remanded the case to the bankruptcy court to determine whether a judicial lien existed under state law—enforceable or unenforceable. It held that "where a judgment gives rise to an unenforceable lien, a debtor may move to avoid that lien under § 522(f). When a judgment fails to give rise to any judicial lien (including an unenforceable lien), however, § 522(f)(1) is superfluous and without application." Avoidance analysis under § 522(f)(1), therefore, requires the bankruptcy court to distinguish between existent, yet unenforceable liens and non-existent liens.

Losing Affirmative Defenses through Substantive Consolidation of Multiple Bankruptcy Estates Does Not Grant Standing Under The "Persons Aggrieved Doctrine."

In *Opportunity Finance, LLC v. Kelley*, 822 F.3d 451 (8th Cir. 2016), the Eighth Circuit affirmed the bankruptcy court's consolidation of debtor and eight special-purpose entities ("SPE"). Upon motion by the trustee, the bankruptcy court found that "PCI and the SPEs were interrelated, and had engaged in massive commingling and the erosion of corporate boundaries." Lenders associated with the SPEs appealed, arguing that, 1) the trustee was estopped from objecting to standing because his certification motion contained an express statement that the district court had jurisdiction to hear the appeals; and (2) they were persons aggrieved, and therefore had standing. The district court upheld the bankruptcy court's ruling.

The Eight Circuit affirmed. To address the lenders' estoppel argument, the Eighth Circuit applied the three, non-exhaustive factors used in judicial estoppel analysis: (1) whether a party's later position is clearly inconsistent with its earlier position; (2) whether the party has succeeded in persuading a court to accept that party's earlier position, so that judicial acceptance of an inconsistent position in a later proceeding would create the perception that the court was misled; and (3) whether the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the party if not estopped.

It found that it was not inconsistent to argue that the lenders lacked standing on appeal, nor did the allegedly inconsistent position create the perception that the court was misled. 28 U.S.C. § 158(a) does not concern standing; rather it governs the finality of the bankruptcy court's orders and judgments.

Second, the lenders then argued that the Bankruptcy Code of 1978 removed all references to the "persons aggrieved doctrine" and therefore it should not be applied. The Eighth Circuit held that the doctrine survived.

Finally, the lenders argued in the alternative that should the person aggrieved doctrine apply, they were persons aggrieved. In related adversary proceedings, the trustee alleges that the SPEs wrongfully transferred funds to the lenders. The lenders argue that the substantive consolidation potentially precluded affirmative defenses in the avoidance actions, and decreased the value of their contingent claims while increasing the trustee's potential recovery. The Eighth Circuit held that "any pecuniary harm to the lenders is several steps removed and not a 'direct' pecuniary impact," as is required under the persons aggrieved doctrine.

The Filing of a Bankruptcy Petition Does Not Sever the Four Unities of Joint Tenancy

In *Peet v. Checkett (In re Peet)*, 819 F.3d 1067 (8th Cir. 2016), the joint debtors held title to real property as joint tenants with one debtor's parents. The joint debtor and her father also owned a Ford pickup as joint tenants. The debtors first filed a petition under chapter 13, but later converted to chapter 7. Post-conversion, the parents died. The trustee asserted the debtors' rights of survivorship, and sought to sell both the real property and the pickup. The bankruptcy court ruled that the joint tenancies remained intact through creation of the bankruptcy estate and allowed the sale. The BAP affirmed.

On appeal to the Eighth Circuit, the debtors argued that the filing of the bankruptcy petition severed the "four unities" of joint tenancy under state law (interest, title, time, and possession), thereby rendering the interests tenancies in common. The debtors relied heavily on an introductory sentence in a recent Supreme Court decision: "When a debtor files a Chapter 7 petition, his assets, with specified exemptions, are *immediately transferred* to a bankruptcy estate." *Harris v. Viegelahn*, 135 S. Ct. 1829, 1835, 191 L. Ed. 2d 783 (2015) (emphasis added). Thus, they argued, the trustee could not sell the property, but only the debtors' interest, thereby prohibiting the outright sale of either.

The Eighth Circuit affirmed the approval of the sale, finding that § 541(a)(1) was specifically created to avoid the "transfer" provisions of its predecessor section in the Bankruptcy Act. As a result, under chapter 7, assets remain in the debtor's name until the trustee disposes of them, and are not automatically "transferred" to the estate. As there was no transfer, there was no severance of the four unities, the joint tenancies were property of the bankruptcy estate, and the trustee was entitled to sell.

Eighth Circuit Holds Funds Diverted by Payment Processor Not Subject to Express Trust, Resulting Trust, Nor Constructive Trust.

In *Rent-A-Center East, Inc. v. Leonard (In* *re WEB2B Payment Solutions, Inc.),* 815 F.3d 400 (8th Cir. 2016), the Eighth Circuit affirmed the district court, which in turn had affirmed the bankruptcy court's decision that the debtor's failure to remit funds per contract did not create an express trust, resulting trust, or constructive trust, and that equitable interests in the funds could be avoided. The debtor provided payment processing services to Plaintiff.

Over a two month period pre-petition, debtor remitted only $9,451,854.44 out of $11,880,076.91 of plaintiff's check proceeds to plaintiff's operating account—leaving a $2.4 million shortage that was diverted to debtor's operating account.

Plaintiff filed a complaint seeking: a declaratory judgment that $801,378.76 in the trustee's possession was plaintiff's funds, a determination that an express or resulting trust existed, or the imposition of a post-petition constructive trust. The bankruptcy court denied plaintiff's claims.

Plaintiff appealed to the district court, which remanded the case to the bankruptcy court. In a restated order, the bankruptcy court ruled: (1) all proceeds were bankruptcy-estate property under 11 U.S.C. § 541(a), (2) no express or resulting trust was created, (3) a post-petition imposition of a constructive trust was not warranted, and (4) whatever equitable interests plaintiff had could be avoided by the trustee's strong-arm powers. The district court agreed.

The Eighth Circuit found that because the payment processing agreement had no requirement to segregate plaintiff's funds, nor a definite, unequivocal, explicit declaration of trust, it could not be considered an express trust under state law.

Under state law, a resulting trust is recognized when parties "indicate an *intent to establish a trust relationship* but fail to reflect that intent in writing." *Dollar Fed. Sav. Bank v. Green Tree Acceptance, Inc*., 1991 U.S. Dist. LEXIS 3827, 1991 WL 40398, at *3 (D. Minn. Mar. 21, 1991). The Eighth Circuit found that because plaintiff was unaware of how its funds were processed by the debtor, plaintiff could not establish the intent needed to imply a trust relationship between the parties.

Under state law, a constructive trust is an equitable remedy "intended to prevent the unjust enrichment of a person holding property under a duty to convey it or use it for a specific purpose." *Koberg v. Jones*, 279 Minn. 406, 157 N.W.2d 47, 52 (Minn. 1968). If legal title to property is obtained through fraud, oppression, duress, undue influence, force, crime, or similar means, or by taking improper advantage of a confidential or fiduciary relationship, a constructive trust arises in favor of the person equitably entitled to the property. *Wright v. Wright*, 311 N.W.2d 484, 485 (Minn. 1981).

The Eighth Circuit found that because the negotiation of checks was done with plaintiff's indorsement by agreement, there could be no showing (by the requisite level of clear and convincing evidence) that conversion occurred, and thus, there was no justification for the imposition of a constructive trust.

Distributions from Spendthrift Trust are Estate Property if Debtor Has Reached Specified Age

In *Thompson-Rossbach v. Doeling*, 541 B.R. 451 (B.A.P. 8th Cir. 2015), the BAP affirmed the bankruptcy court's ruling that distributions from a trust containing a spendthrift provision were property of the estate because the debtor had reached the age when the distributions were fully alienable. Spendthrift trusts prohibit alienation, assignment or other encumbrance. Typically, distributions from a spendthrift trust are excluded from property of the bankruptcy estate under 11 U.S.C. § 541(c)(2). However, the trust at issue had a provision that "any principal distributable to any beneficiary by reason of having attained a specified age shall be fully alienable . . . after attaining such age." As of the bankruptcy petition date, the debtor had reached the specified age of 21. Accordingly, her interest in distributions was alienable and estate property.

Discharge May be Denied for False Oaths

In *Stoebner v. Larson (In re Larson)*, Adv. No. 15-4049, (Bankr. D. Minn. March 2, 2016), the bankruptcy court found the debtor made multiple false oaths and denied his discharge under 11 U.S.C. § 727(a)(4)(A). Under the case law, the party objecting to discharge must prove: (1) the debtor made a statement under oath; (2) that statement was false; (3) the debtor knew it was false; (4) the debtor made the statement with fraudulent intent; and (5) that statement related materially to the bankruptcy case. On his bankruptcy schedules, which are signed under penalty of perjury, the debtor failed to disclose substantial rental income, numerous transfers of assets, and ownership of boats, trailers, and docks. At the meeting of creditors, the debtor again made a false oath about income, assets, and transfers. The court found the debtor knew the statements were false and were made intentionally. This is true even though debtor later amended his schedules to include much of the originally omitted information. The court found the omissions were material. The value of the omissions does not determine materiality, rather the fact that they related to the debtor's assets made them material. Finally, the court found debtor gave no adequate explanation for most of the omissions, finding in part, that claiming to forget about transfers and not knowing what needed to be disclosed was an excuse.

The Bankruptcy Court Rules That Exemptions Concerning Property Coming Into the Estate Pursuant to 11 U.S.C. § 541(a)(5)(A) are Determined at the Time the Property Comes Into the Estate, Not the Petition Date

In *In re Walz*, BKY No. 15-43077 (Bankr. D. Minn., March 15, 2016), the bankruptcy court considered whether the debtor could claim an exemption in real property that came into the estate after the petition date by way of devise, bequest or inheritance within 180 days after filing.

The debtor lived with her parents as of the petition date and identified their address on her petition, although she then claimed no ownership interest in the real property. Within 180 days of the filing, both of the debtor's parents passed away and the debtor continued to reside at the property. A short time later, the debtor received a one-third interest in the real property via the administration of her parents' estate. The debtor subsequently amended her Schedule A to identify her ownership interest in the property pursuant to 11 U.S.C. § 541(a)(5)(A). In addition, the debtor amended her exemptions to claim a homestead exemption.

The trustee objected, arguing that a debtor's exemption rights are determined as of the petition date, and, as of the debtor's petition date, she was not eligible to claim the exemption because she had no ownership interest in the real property.

The bankruptcy court overruled the trustee's objection, determining that the exemption should be determined when the interest becomes property of the estate. The court reasoned that "the determining point of time is when the debtor's ownership interest in the home passed out of her control, and the point of time when the status and rights of the debtor, her creditors, and the trustee with respect to her ownership interest in the home was fixed." Because the debtor owned and occupied the real property when the rights of the debtor, her creditors, and the trustee became fixed, she was entitled to claim a homestead exemption.

The Bankruptcy Court Determines That an Involuntary Petition Fails to Constitute an Informal Proof of Claim

In *In re Acuity Medical International, Inc.*, BKY No. 15-40126 (Bankr. D. Minn., March 8, 2016), the bankruptcy court considered whether an involuntary petition serves as an informal proof of claim.

One of the debtor's petitioning creditors on an involuntary filing failed to timely file a proof of claim in the matter. When the trustee filed his final report, the creditor's claim was listed as subordinate to priority claims and timely filed claims. The creditor did not receive a distribution.

The creditor objected to the final report, arguing that the involuntary petition served as an informal proof of claim. The bankruptcy court disagreed and overruled the creditor's objection.

The bankruptcy court reasoned that to qualify as an informal claim in the Eighth Circuit, the claim must "state the nature and amount of the clam as well as indicate the claimant's intent to hold the debtor liable and pursue the claim" as set forth in *In re Michaels*, 286 B.R. 684, 691 (B.A.P. 8th Cir. 2002).

The bankruptcy court ruled that although the involuntary petition stated the nature and amount of the claim, and further indicated the requisite intent of the creditor to hold the debtor liable, it failed to establish the necessary intent of the creditor to pursue the claim.

The bankruptcy court explained that although an involuntary petition may serve as a first step to show intent to pursue the claim, there must be other steps taken by the creditor. For example, a claimant's objection to plan confirmation could demonstrate intent to pursue the claim. The bankruptcy court also stated that sustaining the creditor's objection would require the adjustment of the trustee's final report and would expose the estate to additional fees, which would ultimately reduce the distribution to other unsecured creditors.

Bankruptcy Court Details the Adequacy of Pleading of Various Claims and Defenses, Including Fraudulent Transfer, Turnover, and Discharge

In *Datawave International, LLC v. Bluesource, Inc. (In re Procedo, Inc.)*, Adv. Pro. No. 13-3158 (April 1, 2016), the bankruptcy court addressed motions to dismiss filed by defendants in response to 14 counts asserted by the plaintiffs. The adversary proceeding arose in connection with a sale of assets in the underlying bankruptcy case.

Specifically, the trustee conducted a § 363 sale of the debtor's software-related assets. More than two years later, the purchaser and trustee commenced the adversary proceeding, with the purchaser asserting that the defendants had pirated the most significant of the assets sold—the program, source code, and licensing keys for certain software—and had been using them unlawfully for their own enrichment. The trustee asserted that defendants' actions had destroyed the estate's share of a stream of future payments from income generated by the assets.

The bankruptcy court's decision provides a detailed analysis of the adequacy of the pleading of the following claims: (1) claims under the federal and state fraudulent transfer statutes; (2) turnover pursuant to 11 U.S.C. § 542; (3) claims regarding violations of the automatic stay; (4) the Minnesota Trade Secret Act; (5) infringement of federal copyright law; (6) claims under various state law causes of action (where the issue was the plaintiffs' failure to identify the governing state law); and (7) unjust enrichment. The bankruptcy court also examined the defendant's claims related to the bankruptcy discharge.

The court concluded that six of the counts should be dismissed with prejudice, and all remaining counts required amendment. The bankruptcy court articulated that the plaintiffs' amendments should evidence a considerably-sharpened analysis as to the appropriate parties for each theory, and that plaintiffs' fact pleading should be equally fine-tuned.

Notably, the court's analysis of the pleading of fraudulent transfer included an in-depth discussion of trustee standing, what qualifies as a "transfer," and timeliness of the suit in connection with equitable tolling of the statutory period for commencement of a suit. The decision also addresses, albeit in a footnote, jurisdictional issues related to the core/non-core divide.

BAP Rules Bankruptcy Court Did Not Abuse its Discretion by Denying Debtor's motion to reinstate Chapter 13 or by Denying Debtor's Reconsideration Motion

The matter of *Paulson v. McDermott (In re Paulson)*, No. 16-6018 (8th Cir. June 3, 2016), arises from a long-running dispute between the debtor and two of his secured creditors that spilled into bankruptcy court when the debtor filed a chapter 13 petition.

The debtor was ultimately unable to confirm a plan and the trustee moved to dismiss. The debtor failed to timely respond to the dismissal motion. The bankruptcy court granted the trustee's motion. Three days later, the debtor filed a response opposing the trustee's motion, and, a few days later, he filed a motion to reinstate the case.

The bankruptcy court denied the debtor's motion to reinstate the case and the debtor filed a motion to reconsider. The bankruptcy court denied that motion too and the debtor appealed.

The BAP affirmed the bankruptcy court's orders, ruling the bankruptcy court did not clearly err in conclusion that the debtor had no meritorious defense to the trustee's motion to dismiss.

The BAP concluded the case wasn't simply about the debtor's failure to timely file a response to the trustee's dismissal motion. Instead, the BAP agreed with the bankruptcy court that given the context of review under Rule 60(b)(1), the court must also consider whether the debtor presented a meritorious defense, if any defense was allowed to be presented late.

The BAP agreed with the bankruptcy court that the debtor's motions merely regurgitated the very same arguments that had been repeatedly rejected by the court. Indeed, the debtor made no effort to correct the impediments to getting his chapter 13 plan confirmed, and, therefore, the BAP determined that the bankruptcy court did not err in refusing to reinstate the case.

Bankruptcy Court Holds That a Chapter 13 Debtor Not Engaged in Business is Not Required to Seek Judicial Authorization to Incur Post-Petition Credit

In *In re: Fields*, 551 B.R. 424 (Bankr. D. Minn. 2016), the bankruptcy court considered whether the Bankruptcy Code requires a chapter 13 debtor who is not "engaged in business" to obtain court approval when seeking to obtain post-petition credit and to incur debt to purchase a vehicle.

The bankruptcy court concluded that court approval was unnecessary under the circumstances, reasoning that nothing in the code required court authorization for a debtor in chapter 13 who is not "engaged in business" to incur post petition debt or to obtain credit. In its ruling, the court determined that the absence of a code provision on the issue did not mean court authorization was essential under the circumstances. The court further reasoned that congress already provided a mechanism by which a debtor may deal with a post-petition change in financial circumstances by allowing for a modification of the original plan.

Accordingly, the court denied the debtor's motion to incur debt and obtain credit as unnecessary.

Bankruptcy Court Lacks Jurisdiction to Amend Judgment Once Adversely Impacted Party Appeals Ruling

In *McDermott v. Hill (In re Hill)*, BKY No. 14-35001 (Bankr. D. Minn. March 3, 2017), the bankruptcy court denied the trustee's motion to amend a judgment relating to the denial of the debtor's discharge.

After the debtor filed a petition for relief, the trustee moved to extend the deadline to file a complaint objecting to the debtor's discharge pursuant to 11 U.S.C. § 727. The same day, the trustee filed the adversary proceeding seeking denial of discharge under four provisions of 11 U.S.C. § 727. The bankruptcy court issued both a written order for judgment and separate judgment denying debtor's discharge. The debtor filed a notice of appeal with the district court. Later, the trustee brought a motion in bankruptcy court to amend the judgment.

The bankruptcy court denied the trustee's motion to amend, holding that established Eighth Circuit precedent regarding the finality of a bankruptcy court's order depends on: (1) the extent to which the order leaves the bankruptcy court nothing to do but to execute the order; (2) the extent to which delay in obtaining review would prevent the aggrieved party from obtaining effective relief; and (3) the extent to which a later reversal on the contested issues would require recommencement of the entire proceeding.

The bankruptcy court held: (1) that it did not have jurisdiction to amend the judgment because there was nothing left for the bankruptcy court to do in the adversary proceeding or bankruptcy case; (2) there are no contingent matters pending and the only way to resolve the matter is by conducting an appellate review; and (3) the debtor only appealed a procedural question and the district court will not require a recommencement of the case as discharge only needs to be denied once.

Finally, the bankruptcy court also determined that it lacked jurisdiction to amend the judgment because the filing of a notice of an appeal confers jurisdiction to the court conducting appellate review divests the originating court of its control over the aspects of the case involved in the appeal.

Bankruptcy Court Determines That the Doctrine of Continued Concealment Applies to Concealed Property, Not Concealed Transfers

At issue in *McDermott v. Petersen (In re Peterson),* Adv. No. 16-06010 (Bankr. D. Minn. Mar. 10, 2017), was the trustee's objection to the debtor's discharge for allegedly failing to disclose assets, failing to disclose transfers of assets, and making false statements under oath.

In the administration of the debtor's estate, the debtor failed to disclose assets and the transfer of assets consisting of a boat, an ATV, and a snowmobile. The trustee objected to discharge under 11 U.S.C. §§ 727(a)(2)(A) and (B), arguing that the transfer of the assets were done with intent to hinder, delay, or defraud creditors.

The evidence presented to the bankruptcy court indicated that the boat was given to the debtor's son almost two years prior to the petition date, that the debtor's son wrecked the ATV and sold it for parts, and that the snowmobile blew up the winter before the petition date.

With regard to the boat, the transfer in question occurred beyond the normal one year look-back period; however, the trustee attempted to use the doctrine of continued concealment. In considering the doctrine, the bankruptcy court found that the concealment must be as to concealed property, not merely a concealed transfer.

The court therefore ruled that the trustee failed to establish that the debtor continued to conceal property, rather she only concealed a transfer. The court also found that the assets were wrecked pre-petition so intent was lacking as debtor received no continued enjoyment of the property.

The trustee also objected to discharge under 11 U.S.C. § 727(a)(4)(A), claiming the debtor made false statements under oath by failing to disclose the boat, ATV and snowmobile on her schedules. The court acknowledged that the debtor made false statements under oath. However, it found the trustee failed to address whether the debtor knowingly made the false statements and failed to prove that the false statements were material. Fraudulent intent was also lacking since the assets had always been considered her children's assets and were given to her children.

Ordinary Course Defense Must be Plead as an Affirmative Defense in a Defendant's Answer.

In *Seaver v. Lindback (In re White),* 557 B.R. 736 (Bankr. D. Minn. 2016), the bankruptcy court granted the trustee's motion for summary judgement on an avoidance claim under 11 U.S.C. § 544 and Minn. Stat. § 513.45. The debtor's mother loaned her approximately $71,000. The debtor made regular monthly payments to her mother from March 2012 through February 2013. No further payments were made until May 2014, when the debtor paid $41,356.24 in partial satisfaction of the indebtedness.

Within the preference period, the debtor filed a petition for relief and the trustee sought to recover the final payment. The trustee brought an adversary proceeding and moved for summary judgment.

In the mother's summary judgment response, she, for the first time, asserted that payments were made in the ordinary course of the business or financial affairs of the debtor. The mother failed to raise the ordinary course defense in her answer or any other previous pleading.

The trustee argued that the mother waived the defense. The bankruptcy court agreed, finding that the list of affirmative defenses found in Fed. R. Civ. R. 8 is inclusive and not exhaustive. The court reasoned that the failure of a party to timely assert ordinary course as an affirmative defense resulted in a waiver of the defense. Otherwise, the trustee would be unduly prejudiced if the defendant was able to enter evidence regarding the defense without giving fair notice to the trustee and an opportunity to respond.

The court also considered whether there was reasonable cause to believe the debtor was insolvent—the only disputed element of Minn. Stat. § 513.45. The court reviewed the transcript for the deposition of the debtor and the defendant. The defendant testified that she knew the debtor could not pay back the full amount of the debt and that the debtor liquidated her stock, "all [she] had," to pay the defendant. Such an admission substantiated the trustee's claim that the mother knew the debtor was insolvent or was rendered insolvent as a result of the transfer.

BAP Rules Secured Creditor's Lien Has Priority Over Cattle Seller's Replevin Claim

In *Sweetwater Cattle Company, LLC v. Murphy (In re Leonard*), 565 B.R. 137 (B.A.P. 8th Cir. 2017), the BAP affirmed the bankruptcy court's decision that the rights of an unpaid seller of cattle were junior to those of the secured creditor who financed the debtor's purchase of the cattle and qualified as a good faith purchaser for value.

The debtor purchased 395 head of cattle from the defendant. A bill of sale was provided to the debtor at the time of delivery. The purchase was financed by the plaintiff, which also took delivery of the cattle from defendant to care for them pending resale by the debtor. Title was then transferred by the debtor to plaintiff as collateral. After delivery of the cattle and bill of sale, several of the debtor's checks to defendant were not honored. Consequently, a balance of more than $800,000 remained payable by the debtor to defendant.

Defendant sought to reclaim the cattle in a replevin action under the UCC. After the debtor commenced a bankruptcy proceeding, plaintiff brought an action for a determination that its claim to any proceeds from the sale of the cattle had priority over defendant's interest and moved for summary judgment in the bankruptcy court.

Defendant argued two points in opposition to plaintiff's summary judgment motion. First, that title never transferred to the debtor because the bill of sale did not comply with a livestock bill of sale under state law. The bankruptcy court rejected this argument, finding that valid title had passed to the debtor despite the lack of strict compliance with the livestock bill of sale. It held that even if defendant only took voidable title, it was sufficient to support the grant of a security interest to plaintiff. The BAP found no error with this ruling.

Second, defendant argued that plaintiff failed to follow reasonable commercial standards of fair dealing in the trade and was therefore not a good faith purchaser. The bankruptcy court relied on plaintiff's undisputed evidence to reject this argument and determined that plaintiff was a good faith purchaser for value, which the BAP found was not in error. The BAP also held that the bankruptcy court had used the correct standard in making this determination. Accordingly, the BAP affirmed the bankruptcy court's grant of summary judgment in favor of plaintiff.

BAP Agrees That Bankruptcy Court May Consider the Emotional Stress of Indebtedness as a Factor in Student Loan Discharge Case

In *Fern v. Department of Education (In re Fern)* 563 B.R. 1 (B.A.P. 8th Cir. 2017), the Eighth Circuit BAP affirmed the bankruptcy court's discharge of student loan debt based upon undue hardship under 11 U.S.C. § 523(a)(8).

The debtor, a single mother of three, owed more than $27,000 in student loan debt. She had never made a payment on her student loan obligations and the loans had always been in forbearance or deferment. The debtor sought to discharge her student loans and the federal government objected.

To determine whether the loans presented an undue hardship, the bankruptcy court applied the Eighth Circuit's "totality of circumstances" test, which considers three factors: (1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependent's reasonably necessary living expenses; and (3) any other relevant facts and circumstances surrounding the particular case.

The bankruptcy court found that the income from the debtor's full-time job and supplemental public assistance was consistent and unlikely to change. Next, the bankruptcy court found that her expenses were reasonable, necessary, modest, and commensurate with her income. It also determined that all of the debtor's monthly income was insufficient to pay her expenses. The bankruptcy court finally considered other factors, including the debtor's inability to obtain credit, the continued accrual of interest and charges added to the debtor's loan balance, the tax burden of canceling the debt many years later, and the emotional burden the debt had on the debtor, finding that these factors supported a discharge.

The federal government objected, arguing there were repayment programs available to the debtor and that the bankruptcy court erred in, among other things, considering the debtor's evidence of emotional distress. The BAP affirmed, stating evidence of eligibility for a repayment plan did not constitute an ability to pay and that the bankruptcy court's consideration of the debtor's emotional stress and other factors was not in error, but served to supplement its totality of circumstances analysis.

Eighth Circuit Rules on Damages Involving Violation of the Automatic Stay and Waiver Regarding Relief From Stay Motion

In *In re Bugg v. Gray (In re Gray)*, 642 Fed.Appx. 641 (8th Cir. 2016) the Eighth Circuit reversed the BAP and bankruptcy court's rulings that creditors had willfully violated the automatic stay when they evicted the chapter 13 debtor from his residence and removed his truck and personal effects therefrom.

The creditors had moved for relief from the stay relating to the real and personal property at issue. Pursuant to § 362(e), the automatic stay terminates with respect to the party making the request if the bankruptcy court does not hold a hearing or rule on the motion within certain statutorily mandated deadlines. Here, the bankruptcy court failed to timely hold a hearing. The BAP determined the creditors waived their right to a timely hearing because they consented.

The Eighth Circuit disagreed, holding that the BAP erred in relying on waiver because waiver is an affirmative defense that was not raised before the bankruptcy court. Accordingly, the appeals court held that the stay was terminated pursuant to § 362(e) because the bankruptcy court did not comply with the statutorily mandated time frames.

The Eighth Circuit also concluded that the bankruptcy court's award of actual damages was improper. The appeals court noted there was no dispute that the creditors willfully took possession of the debtor's personal property. As a result, the debtor was entitled to damages under § 362(k) only if (1) the debtor had a legal or equitable interest in the property; and (2) to the extent he had such interests, those interests remained property of the estate. The Eighth Circuit held damages were not appropriate because the items of personal property were divested from the estate by the debtor's claimed exemptions for their full value. As a result, the Circuit reversed.

Eighth Circuit Holds a Chapter 11 Debtor Objecting to Its Own Plan May be a Person Aggrieved and has Standing to Appeal Confirmation Order

In *O&S Trucking, Inc. v. Mercedes Benz Fin. Serv. USA (In re O&S Trucking, Inc.)*, 811 F.3d 1020 (8th Cir. 2016). the debtor owned and operated a fleet of commercial trucks that were financed by or leased from creditor. The debtor brought a motion to determine the creditor's secured status prior to confirmation. The bankruptcy court concluded that the creditor had a partially secured claim and a remaining unsecured claim. The debtor moved for reconsideration of the secured-status order, which the bankruptcy court denied.

The debtor appealed the order and the denial of reconsideration. While the appeal was pending, the debtor proposed a plan of reorganization. The plan incorporated the bankruptcy court's secured-status order and also stated that the sum of the creditor's claim was "subject to adjustment" based on the "final outcome of the pending appeal." The plan was eventually confirmed. The BAP subsequently dismissed the appeal for lack of jurisdiction.

The debtor appealed the confirmation order to the BAP. Its notice of appeal identified three orders: (1) the secured-status order; (2) the denial of the reconsideration; and (3) the plan confirmation order. It was ultimately agreed that the secured-status order and the denial of reconsideration were interlocutory appeals. The BAP determined that the debtor lacked standing to appeal the confirmation order and dismissed the matter for lack of jurisdiction.

The Eighth Circuit considered the "person aggrieved" standard for determining whether the debtor had standing to appeal the confirmation order. Under this standard, the appellant has the burden to demonstrate that the challenged order directly and adversely affected his pecuniary interests.

The appeals court noted that it previously outlined the procedure through which a chapter 13 debtor may seek review from a confirmed plan in *Zahn v. Fink (In re Zahn),* 526 F.3d 1140 (8th Cir. 2008). In *Zahn* the Eighth Circuit concluded "a debtor who objects to her own plan may be an aggrieved party and have standing to appeal confirmation of such plan." Though *Zahn* applied specifically to a chapter 13 debtor, the Eighth Circuit determined that it applies equally to a chapter 11 proceeding because the person-aggrieved standing requirement extends to proceedings under both chapters.

In this case, the debtor failed to object to its proposed plan and therefore did not obtain an adverse ruling along with the order confirming the plan. The debtor's failure to object was fatal to its ability to appeal the order because it was not an aggrieved person.

The appeals court also held that plan language stating that the claim was "subject to adjustment" based on "the final outcome of the pending appeal" was insufficient to meet *Zahn*'s requirement that a debtor must object to the plan to demonstrate person-aggrieved status.

Bankruptcy Court Holds That Trustee, Standing in Shoes of Debtor, Has Standing to Pursue Claims Against Bank

In *Kelley v. BMO Harris Bank N.A. (In re Petters Company, Inc.),* 565 B.R. 154 (Bankr. D. Minn. 2017), the bankruptcy court mostly denied the bank's motion to dismiss, allowing the trustee's claims under the Minnesota Uniform Fiduciaries Act as well as claims for aiding and abetting fraud to proceed as pled, and further ruling a claim for breach of fiduciary duty could proceed on a narrowed basis.

The bankruptcy court held that the trustee—who oversees a liquidating trust established pursuant to a confirmed chapter 11 liquidating plan in the aftermath of the Petters Ponzi scheme—had standing to pursue such claims on the basis of harm done directly to the debtor or as derivative claims. The bankruptcy court further determined that it would not apply the equitable defense of *in pari delicto* to dismiss claims at this stage of the litigation. The bankruptcy court did dismiss a civil conspiracy claim against the bank for lack of standing.

BAP Upholds Bankruptcy Court's Finding of Defalcation Under § 523(a)(4) for Diverting Employee Health Plan Premiums

In *United States DOL v. Harris (In re Harris),* 561 B.R. 726 (B.A.P. 8th Cir. 2017), the BAP affirmed the bankruptcy court's grant of summary judgment in favor of the federal government on a § 523(a)(4) exception from discharge action against the debtor, holding the bankruptcy court did not err in: (1) giving collateral estoppel effect to a district court's findings in an ERISA suit against the debtor that funds withheld from employee wages for insurance premiums constituted a trust res and that ERISA imposed fiduciary duties upon the debtor with respect to those funds; (2) that the bankruptcy court did not err in concluding that the ERISA fiduciary duties satisfied § 523(a)(4)'s definition of a fiduciary; and (3) that undisputed facts supported a conclusion that the debtor committed defalcation while acting in the fiduciary capacity under § 523(a)(4).

The debtor was the company's CEO. The company administered an employee health insurance plan and withheld funds from employees' wages to fund plan premiums. However, the debtor failed to remit all withheld funds to the insurance provider to pay plan premiums, instead diverting such funds to pay corporate expenses and the debtor's personal home equity loan. After receiving a series of untimely payments and bounced checks from company, the insurance provider canceled the plan due to nonpayment.

The federal government sued the debtor in district court and obtained a judgment against him for breaching the fiduciary duty of loyalty to the employees and the plan under ERISA by failing to remit withheld premium payments to the insurance provider. Soon thereafter, the debtor filed a voluntary chapter 7 petition. The federal government filed a proof of claim for the judgment and an action to except the debt from discharge under § 523(a)(4).

The bankruptcy court eventually granted summary judgment to the federal government, applying collateral estoppel with respect to the district court's findings and determining that the debt was excepted from dischargeable under § 523(a)(4) because: (1) a trust was created when the funds were withheld; (2) the debtor had fiduciary duties with respect to the trust to remit the funds for payment of plan premiums; and (3) the debtor committed defalcation by directing other uses for the funds.

On appeal, the debtor argued that no express trust was created and that he had no § 523(a)(4) fiduciary duties. The BAP disagreed, holding that the substance of the transaction determines whether a fiduciary relationship exists and finding no error in the bankruptcy court's determinations that a trust res was created when funds were withheld from the employees' wages for the plan premiums, that the trust imposed upon the company a fiduciary duty to remit the withheld funds to pay premiums, and that the debtor committed defalcation under § 523(a)(4) when he knowingly failed to remit the funds to pay the plan premiums.

Eighth Circuit Affirms Dismissal of Chapter 11 Case Where Case was Pending for Three Years and Debtor Could Not Present Confirmable Plan

In *Diwan, L.L.C. v. Maha-Vishnu (In re Diwan, L.L.C.)*, 848 F.3d 1147 (8th Cir. 2017), the Eighth Circuit affirmed the bankruptcy court's claim objection determination, denial of confirmation, and dismissal of the debtor's chapter 11 case.

The bankruptcy court had overruled the debtors' claim objection, rejecting the debtor's impairment of collateral defense. The bankruptcy court also sustained certain objections to the plan, concluding that the plan would in any event fail the best interest of creditors test. Further, the bankruptcy court denied plan confirmation and granted the trustee's motion to dismiss the case, noting that the case had been pending for three years and that the debtor's failure to present a confirmable plan resulted in substantial and continuing losses for creditors.

The debtor appealed, and the district court affirmed. On appeal, the Eighth Circuit ruled that feasibility concerns remained even if the debtor's impairment of collateral defense was accepted. The BAP also ruled that the bankruptcy court did not abuse its discretion in dismissing the case under 11 U.S.C. § 1112(b)(4)(A), finding a sufficient basis in the record to defer to the bankruptcy court's broad discretion with respect to chapter 11 dismissal issues.

BAP Rules Post-Discharge Attempt to Collect Nondischargeable Obligations Did Not Violate Discharge Injunction, Even Though Amount Sought was Previously Disallowed

In *Missouri v. Spencer (In re Spencer)*, 550 B.R. 766 (B.A.P. 8th Cir. 2016), the BAP reversed a bankruptcy court's orders for contempt and sanctions against the state, holding the state did not willfully violate the discharge injunction because the injunction did not apply to a domestic support obligation even though the sum the state attempted to collect had been disallowed by previous bankruptcy court order.

In the chapter 13 bankruptcy case, the state filed an unsecured priority claim for approximately $36,000 of unpaid domestic support obligations. Later, the state discovered it had miscalculated the amounts due from 2005 to 2011, and amended its proof of claim to approximately $88,000. The debtor objected to the amended proof of claim. Following a hearing, the bankruptcy court sustained the objection, and allowed the claim as originally filed. The state did not seek reconsideration or appeal that order, and did not object to confirmation of a plan that proposed to pay the allowed claim amount.

The debtor made plan payments and received a discharge. Thereafter, the state attempted to collect the disallowed amount. The debtor filed a motion for contempt and sanctions against the state for violating the discharge injunction. The bankruptcy court granted the motion and ordered the state to pay the attorneys' fees incurred by the debtor.

The state appealed. The BAP reversed, holding the state did not willfully violate the discharge injunction because the discharge injunction does not apply to domestic support obligations under §§ 523(a)(5) and 1328(a). The BAP found that since the support obligation was not subject to the discharge under § 1328(a)(2), it was also not subject to the discharge injunction under § 524(a)(2), and accordingly the bankruptcy court abused its discretion in holding the state in contempt and awarding attorneys' fees.

District Court Affirms Bankruptcy Court's Decision That It Lacks Authority to Order Substantive Consolidation When Doing So Would Violate an Explicit Bankruptcy Code Provision and That Insufficient Facts Supported Consolidation Motion

In *The Official Committee of Unsecured Creditors v. The Archdiocese of Saint Paul and Minneapolis, et al. (In re The Archdiocese of Saint Paul and Minneapolis)*, Civil No. 16-2712 (D. Minn. Dec. 6, 2016), the district court affirmed the bankruptcy court's order granting motions to dismiss the unsecured creditors committee's motion to consolidate the debtor with more than 200 Catholic nonprofit, non-debtor entities.

As a preliminary matter, the district court held that the committee had standing to appeal the bankruptcy court order under the "person aggrieved" standard, which states that a party has standing to appeal if it has a financial stake in the bankruptcy court's order. The district court found the committee had a direct pecuniary interest in the order because its constituents were creditors of the bankruptcy estate and the order impacted the amount and extent of assets to be included in the estate.

The district court then affirmed both of the two independent grounds on which the substantive consolidation motion was denied and motions to dismiss were granted. First, the district court agreed that the bankruptcy court lacked authority to substantively consolidate the charitable, non-debtor entities—thereby forcing them into bankruptcy over their objection—because it would be inconsistent with § 303(a) of the bankruptcy code. Specifically, § 105 of the code gives bankruptcy courts broad equitable powers to carry out the provisions of the code, and is the source of authority for a bankruptcy court to order substantive consolidation. However, the district court determined that § 105 does not allow a bankruptcy court to override explicit mandates of other sections of the code.

Key to the ruling is § 303(a) of the code, which expressly prohibits the commencement of an involuntary bankruptcy case against "a corporation that is not a moneyed, business, or commercial corporation," and its legislative history, which provides the example of eleemosynary institutions, such as churches, schools, and charitable organizations and foundations. The district court held that because substantive consolidation would force the non-debtor entities into bankruptcy against their will, it would violate an explicit mandate of the code. Accordingly, the district court determined that the bankruptcy court lacked authority to order substantive consolidation.

Second, the district court affirmed the bankruptcy court's holding that, even if the bankruptcy court had authority to order substantive consolidation, the committee failed to allege sufficient facts to support substantive consolidation. The district court compared the Eighth Circuit's *Giller* factors for substantive consolidation with the facts alleged by the committee. The district court held that, for each factor, the facts alleged by the committee, even when taken as true and given the benefit of all reasonable inferences, did not meet the *Twombly* and *Iqbal* pleading requirements. Accordingly, the district court determined the motion could not survive dismissal.