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Prepetition Retainer is not Property of the Estate After it has been Paid in Chapter 11 Case

In *In re Next Generation Media, Inc.,* No. 10-40097, Judge Kressel declined to order disgorgement of a pre-petition retainer. Next Generation Media, Inc. paid its attorneys a $25,000.00 retainer. Subsequently, the debtor filed a petition under chapter 11. The court entered an order approving the employment of the debtor's attorneys and authorizing the debtor to pay monthly invoices to the extent of 80% of fees and 100% of costs, pending court approval of the fees. Although the debtor's attorneys successfully negotiated a cash collateral agreement, the debtor defaulted. The debtor voluntarily converted the case to one under chapter 7 after the attorneys rendered legal services totaling $166,445.37.

The chapter 7 trustee determined that the estate was administratively insolvent. After the chapter 7 trustee filed his final report, the debtor's attorneys filed a fee application. The chapter 7 trustee and the United States Trustee responded to the fee application by asking that the attorneys disgorge the pre-petition retainer and turn it over to the trustee as property of the estate so that it could be redistributed pro rata to all the chapter 11 administrative claimants.

The court rejected the argument for disgorgement because § 726 does not provide any authority to collect property, but merely authority to distribute property of the estate. The court rejected the argument for turnover and held that the retainer was no longer property of the estate because it had been fully earned and drawn upon prior to the conversion of the case. While the court acknowledged that any unearned portions of the retainer could be property of the estate subject to turnover, here "[a] transfer of property rights occurred after [the attorneys] rendered services and when they drew upon the retainer."

Finally, the court rejected the United States Trustee's arguments that the retainer was still property of the estate because the fees had not been allowed pre-conversion. The court pointed out that § 549 provides for avoidance of only "unauthorized" post-petition transfers, and in this case the transfers had been authorized by the order approving the employment of the debtor's attorneys.

Lower Court not Bound by its Earlier Rulings unless Explicitly or Implicitly Adopted by the Appellate Court

In *In re Tri-State Financial, LLC, (Case No. 14-6018, 8th Cir. BAP)*, the trustee for a chapter 11 debtor filed an adversary proceeding to determine ownership of $1,190,000 he received from bankruptcy estate of a related chapter 7 debtor. A creditor of the chapter 11 debtor claimed the funds were subject to its blanket security interest in a Chapter 11 debtor's assets. The bankruptcy court ordered that the funds were not the property of the bankruptcy estate, and awarded the trustee legal fees and expenses.

The BAP reversed and remanded. The case was assigned to a new judge, who, on remand, determined that the funds were property of chapter 11 debtor's estate and subject to the creditor's security interest, but still awarded the chapter 11 trustee its legal fees and expenses.

On review of the second appeal, the BAP reviewed whether the bankruptcy court exceeded its mandate on remand, but affirmed the revised determination because a court on remand is free to pass upon any issue that not expressly or impliedly disposed of on appeal. The BAP also held that the law of the case doctrine only applies to decisions that have not been appealed and that on remand, a lower court is not bound by its earlier rulings unless explicitly or implicitly adopted by the appellate court.

Finally, the BAP held that following retirement of bankruptcy judge originally assigned to the chapter 11 case, the bankruptcy court failed to certify familiarity with the record and determined the case could not be completed without prejudice to the parties, warranting remand.

Lessor Loses Out on Rejection Damages Due to Untimely Objection

In *In re Sky Ventures, LLC*, Case No. 14-42107 (Bankr. D. Minn. Dec. 23, 2014), a lessor of nonresidential real property was not entitled to an administrative claim for the period after the deemed rejection date of the lease.

The debtor, a franchisee of sixteen Pizza Hut restaurants, filed a chapter 11 petition on May 14, 2014. On June 27, 2014, it moved to reject a particular lease of real property, and requested that rejection be effective as of the petition date. The lessor did not object. The court granted the motion and set a deadline for filing rejection damage claims. The lessor did not file a claim by the deadline. Instead, it filed a motion asking the court to amend the rejection date order and allow an administrative claim for post-petition rents and charges.

The bankruptcy court refused to revisit the rejection date order. The retroactive rejection was defensible as a legal matter and the lessor had failed to object to the motion or appeal the order. In addition, the lessor did not qualify for reconsideration under Rule 60, applicable pursuant to Federal Rule of Bankruptcy Procedure 9024. Simply put, the debtor lacked a good excuse for missing the objection deadline. For those advising lessors, this case serves as a reminder to observe diligence.

To Establish the Contemporaneous Exchange for New Value Defense to a Preference Action a Transferee Must Prove Intent for a Contemporaneous Exchange

In *Dietz v. Calandrillo (In re Genmar Holdings, Inc.)* (Case No. 13-3023, 8th Cir.), the Eighth Circuit affirmed the BAP and held that in order to establish a contemporaneous exchange for new value a transferee must prove that the parties intended a contemporaneous exchange.

The debtor's subsidiary sold the defendant a boat that the defendant claimed to be defective. The parties agreed to settle the dispute with the defendant agreeing to return the boat with clear title in exchange for $205,000.00. The parties agreed that the debtor would pay directly to a third party lien holder the $140,000.00 necessary to satisfy its lien on the boat and the third party would release its lien. "The remainder of the Settlement Payment shall be paid… no sooner tha[n] 15 days after [Debtor] receives the lien waiver

confirming the Bank's discharge of the lien and all title assignment documents… for the Boat." The day after the settlement agreement, the third party lien holder received payment and assigned title documents to debtor shortly thereafter. Nineteen days later, and within the 90-day preference period, the debtor issued a check for the remaining $65,000.00 to Defendant.

Defendant argued that the $65,000.00 transfer was a contemporaneous exchange for new value defense protected by § 547(c)(1). The Eighth Circuit found that the defendant "presented no evidence permitting a reasonable fact-finder to find that the parties to the settlement agreement intended a contemporaneous exchange for new value." The court stated that while the debtor received payment nineteen days after the conveyance of the boat, the "time lag, by itself, does not resolve whether the transaction was intended to be a 'contemporaneous exchange," noting that "[m]any exchanges the parties intend to be contemporaneous cannot be completed instantly, or even within a few days."

While the parties agreed on a multi-step process to accomplish the exchange of the boat for the settlement funds which led to some delay, the "settlement agreement provided that the final $65,000.00 payment would be made to the [Debtor] *no sooner* than fifteen days after [Debtor] received the lien waiver and title documents." The agreement evidenced a short-term loan. The agreement to delay payment by at least 15 days after transfer of the boat defeated the assertion of an intended contemporaneous exchange.

Underlying Loan Documents Determine Whether an Oversecured Creditor may Recover Fees and Costs

In *Starion Financial v. McCormick (In re McCormick)*, No. 14-6008 (BAP 8th Cir. Dec. 24, 2014), the BAP reversed a bankruptcy court order regarding whether an oversecured creditor could receive fees and costs pursuant to § 506(b).

The creditor made loans to the the debtors governed through various promissory notes, mortgages, guaranties, and workout agreements. Some or all of these documents provided that the debtors were liable for payment of attorneys' fees and costs of collection. Before the debtors' bankruptcy filing, the lender obtained judgments against the debtors based on amounts owed under the loans. The judgments became a lien on additional real property of the debtors, after which the lender became oversecured.

The debtors' confirmed plan provided for payment of "allowable" attorneys' fees and costs of oversecured creditors, and the lender sought payment of fees and costs. The debtors objected.

The bankruptcy court applied § 506(b), which requires, among other things, that "the entitlement to fees and costs must be provided for under the agreement or state statute under which the claim arose[.]" The court held that the applicable agreements were the judgments. Because the judgments did not explicitly grant the appellant its fees and costs, the court held that the lender could not recover fees and costs.

The BAP reversed, finding that the judgments were not the applicable agreement under § 506(b). Instead, the applicable agreements were the promissory notes, mortgages, workout agreement, and related loan documents. The BAP stated that the judgments were merely a means of enforcing the right to payment, and obtaining additional collateral to secure payment. The BAP held that "section 506(b) does *not* require that the right to fees be provided in the agreement under which the creditor became oversecured. It also does not require that it be in *all* agreements that make up the secured claim of the creditor." Here, because one or more of the applicable agreements—the promissory notes, mortgages, workout agreement, and related documents—provided for the payment of fees and costs, the BAP reversed and remanded to the bankruptcy court for a determination as to the reasonableness of the fees and timeliness of the fee request.

Various Arguments to Delay and Defeat Mortgage Foreclosure Overruled

In *Carlson v. U.S. Bank, N.A.* (Case No. 14 – 6013, 8th Cir. BAP) the BAP affirmed various orders of the bankruptcy court which overruled various debtor objections to a pending mortgage foreclosure

The debtors filed a *pro se* chapter 13 case primarily to halt a pending foreclosure action of their residential condominium. The foreclosing lender moved for relief from the automatic stay. The debtors filed a Motion for Violation of Automatic Stay, Violation of Homestead Exemption, Violation of Discharge and Creditor Misconduct.

The bankruptcy court denied the debtors' motions. The BAP reviewed the orders under an abuse of discretion standard. All three bankruptcy court orders referred to findings and conclusions made on the record at corresponding hearings. Debtors failed to provide transcripts of the hearings as required by Federal Rules of Bankruptcy Procedure 8006 and 8009(b). Thus, the BAP was unable to hold that the factual basis for dismissal and bar to refiling was clearly erroneous based on their inability to review all required evidence.

Further, Debtors' legal arguments lacked merit. Debtors argued liens against their condominium residence did not survive their previous Chapter 7 discharge. Liens survive discharge unless expressly avoided. Debtors also asserted the homestead exemption wipes out liens which is also incorrect. Finally, the debtors argued that the postponing of a foreclosure sale violates the automatic stay, which is incorrect. Based on the debtors' inability to prove the bankruptcy court made clearly erroneous factual and legal conclusions, the BAP affirmed the bankruptcy court orders.

District Court Affirms Bankruptcy Court's Finding of Insolvency for Constructive Fraudulent Transfers and Deems Creditor's Challenge to Standing for Lack of Predicate Creditor Waived

In *BMO Harris Bank, N.A. v. Stoebner*, (D. Minn. 14-1748) the district court affirmed the bankruptcy court's insolvency finding and held predicate creditor arguments could not be raised for the first time on appeal.

The case involved constructive fraudulent transfers that creditor received from the

debtor during a four-year period. The transfers were made by the corporate debtor for the direct benefit of the its sole owner and president as loan payments on his mortgage and home equity line of credit for his vacation home in Arizona. The transfers lacked reasonably equivalent, there being no obvious indirect benefit to the debtor transferor.

Primarily at issue was the insolvency of the debtor at the time of the transfers. The parties' experts reached competing conclusions on the issue of insolvency, but the bankruptcy court found the trustee's expert more credible and held that the debtor was insolvent at the time of the transfers which rendered them avoidable.

On appeal, the transferee challenged the finding that the debtor was insolvent because the bankruptcy court failed to value the debtor as a going concern. Rather, the bankruptcy court only considered balance sheet assets and liabilities. Additionally, transferee argued that the bankruptcy court erred when it admitted the "bare insolvency opinion" of the trustee's expert, who according to the transferee "failed to conduct a valuation to support his opinion."

The Bankruptcy Code defines an entity as insolvent if it is in a "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at fair valuation." 11 U.S.C. § 101(32)(A). The Minnesota Uniform Fraudulent Transfer Act similarly provides that a debtor is insolvent if "the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation." Minn. Stat. § 513.42(a).

The district court agreed with the bankruptcy court's finding of insolvency. The bankruptcy court relied primarily on the balance sheets of the debtor, the trustee's testimony and his expert witness. The balance sheets indicated an excess of liabilities over assets at the beginning of the payment period and the trustee testified that the debtor was insolvent during the payment period because its liabilities exceeded the fair value of its assets. In reaching his opinion on insolvency, the trustee's expert testified that he relied not only on the debtor's balance sheets, but also on other information such as the debtor's financial statements, goodwill and sustainability of earnings. The district court held that the bankruptcy court did not err in weighing the credibility of the parties' expert witnesses.

The district court considered whether the bankruptcy court erred in ruling that the transferee waived its challenge to the trustee's standing under 11 U.S.C. § 544(b), which requires the trustee to demonstrate the existence of at least one predicate creditor with an unsecured claim from which the trustee derives standing. The court found that the trustee alleged the existence of several identified predicate creditors, and that was unchallenged by the transferee until appeal. Thus, the transferee waived the argument.

BAP Holds Administrative Expense Claim Analysis Turns on Whether Equipment Lease is a "True Lease" or a Disguised Security Instrument

In *GE Capital Commercial, Inc. v. Sylva Corporation, Inc. (In re: Sylva Corporation, Inc.)*, No. 14-6016 (8th Cir. BAP, Nov. 26, 2014), the BAP reversed the bankruptcy

court's decision denying the creditor's motion for allowance of an administrative expense claim for the debtor's unpaid lease obligations and remanded.

The debtor entered into an agreement to lease certain equipment from the creditor used in the debtor's business operation. The agreement contained multiple end-of-lease options, any of which the debtor could exercise by complying with certain provisions. The debtor did not exercise any options. Accordingly, the lease automatically renewed on a month-to-month basis until such time as either party provided the other with a 90-day termination notice.

The debtor filed a petition under Chapter 11 of the bankruptcy code. About a month later, the lessor filed a proof of claim, specifically characterizing the lease as a "true lease." The debtor did not object to the proof of claim.

The lessor filed motions for an order compelling the debtor to assume or reject the lease and for relief from the automatic stay or, alternatively, granting adequate protection. In response, the debtor argued the lease expired and there was no lease in force to assume or reject.

Prior to the hearing, the parties entered into a settlement and stipulation that recognized the lessor's interest in the equipment, agreed to past due amounts owing by debtor under the lease, provided for the debtor to surrender the equipment to the lessor, and authorized the debtor to reject the lease. The stipulation reserved each of the parties' rights, including the debtor's right to contest any claims made by the lessor,

Thereafter, the lessor filed the underlying motion for an administrative expense, requesting allowance for all of the lease payments from the bankruptcy petition filing date until the date the lease was rejected, plus attorneys' fees and expenses incurred to reclaim the equipment. The debtor objected, arguing the lease was not a true lease and rather a financing agreement. Before the hearing, the parties filed a stipulation of facts, which stated the lease was rejected. This stipulation did not include a reservation of rights.

The bankruptcy court heard and denied the creditor's motion. In its ruling, the bankruptcy court stated it would only analyze the motion under § 503(b)(1)(A) and would not consider § 365(d)(5). This meant the lessor had the burden to prove by a preponderance of the evidence that the estate received a tangible benefit for the use of the equipment, which the bankruptcy court ruled the lessor did not meet.

The BAP reversed, stating the bankruptcy court erred in declining to consider the lessor's motion under § 365(d)(5), which effectively shifted the burden of proof from the objecting party to the claimant. However, the BAP recognized that § 365(d)(5) would only apply if the lease was a "true lease," a determination the bankruptcy court did not make. The BAP therefore remanded, requesting a determination of whether a dispute still existed as to whether the lease is a "true lease." If a true lease, the BAP instructed the bankruptcy court to analyze the claim under § 365(d)(5) for the time period commencing on the 60th day after the petition filing date and to also analyze the claim under § 503(b)(1)(A) for the 60 days prior.

Eighth Circuit Rules that Bank's Post-Petition Replevin Action was not a Willful Violation of the Automatic Stay

In *Carter v. First National Bank of Crossett (In re: James Allen Carter, Jr.)*, No. 14-1182 (8th Cir., Nov. 17, 2014), the Eighth Circuit affirmed that the bankruptcy court correctly denied sanctions against a bank for its violation of the automatic stay under 11 U.S.C. § 362 because the violation was not willful.

The debtor petitioned for relief under Chapter 13. After the filing, the bank continued to pursue a state court replevin action for logging equipment, which a logging company owned by the debtor pledged as security for two promissory notes in favor of the bank. Although unknown to the bank, before the filing the debtor assigned logging company's assets to himself.

The debtor received notice of the state court suit but failed to respond or file any objection until after the state court issued an order granting the bank immediate possession of the equipment. The debtor then requested the state court to stay the order based on the bankruptcy filing and the assignment. This was the first time the bank heard of the assignment.

The state court directed the county sheriff to repossess the equipment and retain it until further order of the court. The bank, who disputed the assignment, sent a letter to the logging company explaining its redemption rights regarding the equipment.

The debtor then filed motions with the bankruptcy court alleging the bank violated the automatic stay and requesting sanctions. Following an evidentiary hearing, the bankruptcy court found the bank did not willfully violate the automatic stay and it denied sanctions.

The debtor appealed. The BAP affirmed, determining that although the bank violated the automatic stay, the violation was technical and not willful.

The debtor appealed again, arguing that the bank's initial repossession of the logging equipment and the continued failure to return the equipment constituted willful violations of the automatic stay.

The Eighth Circuit rejected the debtor's arguments, reasoning the bank was unaware of the assignment or the bankruptcy petition when it initially sought replevin. Accordingly, no willful violation could have then occurred. Additionally, after the debtor's motion, the state court directed the sheriff to take possession of the equipment. The bank also continued to dispute the validity of the assignment and whether the equipment was property of the bankruptcy estate. The bank also sent its redemption letter to the logging company, not to the debtor individually.

Under the circumstances, the Eighth Circuit held that the automatic stay violations were not willful and it denied the imposition of sanctions.

LLC's Member Lacks Standing to Appeal Where the LLC is the Creditor

In *Conway v. Heyl (In re Heyl)*, No. 14-1453 (8th Cir. October 22, 2014), the court considered whether an LLC member had standing to appeal an adverse ruling of the bankruptcy

appellate panel. The LLC filed a proof of claim, and the LLC and its members brought an adversary proceeding against the debtor, arguing that the debt owed to the LLC was not dischargeable. The court ruled in favor of the debtor.

Both the LLC and its member appealed the bankruptcy court's decision. The LLC's attorney withdrew as counsel and the member dismissed LLC from the appeal. The member then proceeded *pro se*. The BAP dismissed the appeal, holding that the LLC's member did not have standing to appeal because the proof of claim demonstrated that LLC and not its was the creditor.

The Eighth Circuit affirmed, relying on the person-aggrieved doctrine. Because the member is not a licensed attorney, he also could not litigate on behalf of the LLC.

When Considering Undue Hardship, a Court may Consider a Debtor's Ability to Enroll in an Income-Based Repayment Plan

In *In re Nielsen*, 518 B.R. 529 (B.A.P. 8th Cir. 2014), the BAP affirmed the bankruptcy court's decision to deny the debtor's request for student loan discharge. The BAP determined that it was proper for a court to consider the debtor's failure to enroll in an Income Contingent Repayment Plan ("ICRP").

The bankruptcy court had applied the totality-of-the-circumstances test and determined that the debtor failed to meet her burden proving an undue hardship. The debtor appealed because the bankruptcy court considered her ability and failure to enroll in an ICRP. Specifically, the bankruptcy court considered the fact that the debtor's payments would be zero under the applicable ICRP in its basis for denying the debtor's request.

The BAP affirmed, stating that it was proper for the bankruptcy court to consider the applicable repayment terms under an ICRP for the purposes of its totality-of-the-circumstances analysis.