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SUPREME COURT'S TRAVELERS' DECISION ALLOWED BROAD THIRD PARTY RELEASES TO SURVIVE

In *Travelers Indem. Co. v. Bailey*, No. 08-295, the U.S. Supreme Court, in a 7-2 opinion, found that the Second Circuit erred in determining whether a bankruptcy court may prohibit future claims against the insurer of the debtor by third-parties who were not involved in the original bankruptcy proceedings.

In 1986, as part of the reorganization plan of insured Johns-Manville Corp., the bankruptcy court approved a settlement of insurers, including Travelers Indemnity Co.'s (Travelers), in asbestos-related litigation. It enjoined non-settling third-parties from future litigation with Travelers. The orders were subsequently affirmed by the district court and the Second Circuit.

More than a decade later, plaintiffs began filing actions against Travelers for alleged violations of state law. Travelers sought the protection of the earlier plan confirmation order, arguing that the injunction disallowed such actions. The bankruptcy court agreed with Travelers, but the Second Circuit reversed, finding that the bankruptcy court lacked subject matter jurisdiction to prevent such lawsuits, since the tort claims did not involve the Manville estate.

The Supreme Court held that the Second Circuit erred in considering whether the bankruptcy court had authority to issue the original 1986 injunction, as the issue was not properly before it. The Supreme Court reasoned that once the orders became final, whether or not they involved the proper exercise of bankruptcy court power and jurisdiction, they became res judicata as to the parties and those in privity with them. The Supreme Court thus upheld the enforceability of a broad third-party release because the time to challenge the jurisdiction of the bankruptcy court and the entry of the order had expired. However, the Supreme Court offered no opinion as to whether such third-party release was proper.

EIGHTH CIRCUIT EXPANDS TRANSFERS EXPEMPT FROM AVOIDANCE UNDER 11 U.S.C. § 546(e)

In *Contemporary Indus. Corp., et. al v. Frost, et. al*, 564 F.3d 981 (8th Cir. 2009), the Eighth Circuit upheld the bankruptcy and district court's determination that payments made to shareholders in exchange for their stock in a privately-held corporation were exempt from avoidance under 11 U.S.C. § 546(e).

Contemporary Industries Corp. ("Contemporary"), a privately-held corp., became the target of a leveraged buyout. The acquiring group set up a separate entity, Contemporary Industries Holding ("CIH"), to facilitate the acquisition. CIH obtained significant loans to cover the purchase. CIH deposited the loan proceeds and shareholders deposited their shares in First National Bank. The parties entered into an escrow agreement regarding the distribution of the purchase price. First National acted as the escrow agent.

A few years later Contemporary filed for Chapter 11. Contemporary and its unsecured creditors committee commenced an adversary proceeding to recover the payments made to Contemporary's former shareholders on the grounds that the payments were fraudulent transfers avoidable under 11 U.S.C. § 544.

The bankruptcy and district courts disagreed, holding that the payments were exempt from avoidance as settlement payments made by or to a financial institution. The Eighth Circuit agreed.

The court first addressed Contemporary's argument that the payments where not settlement payments within the meaning of section 546(e) because the payments were for privately-held securities. As an issue of first impression, the court considered the decisions of sister circuits who had addressed the issue. In finding the transfers at issue exempt from avoidance, those circuits concluded (1) that section 741(8)'s definition of settlement payment is "extremely broad" and (2) that the term "settlement payment" is one of art in the securities trade generally referring to a transfer made to complete a securities transaction.

Agreeing with these circuits, the court held that section 546(e) text was plan, unambiguous and that the term "settlement payment" was intended to sweep broadly and encompass transfers made to complete a securities transaction. In so doing, the court declined to address Contemporary's argument that those decisions were distinguishable because they involved publicly traded companies and that the general rationale of those decisions (and the legislative history of section 546(e)) made clear that section 546(e) was enacted to protect the nation's financial markets.

Having concluded the transfers constituted settlement payments, the court turned its attention to Contemporary's argument (and 11th Circuit precedent) that the payments were not made "by or to a financial institution" because First National, as merely escrow agent, never obtained beneficial interest in the payments and therefore could be a transferee

The court, again relying on the plain text of 546(e) and the decisions of sister circuits, rejected Contemporary's argument. Nothing in the text of section 546(e) requires that the financial institution require a beneficial interest in the settlement payment, the court explained and therefore transfers were exempt from avoidance under section 546(e) as settlement payments.

IRA ACCOUNTS EXEMPT EVEN IF NOT EMPLOYMENT RELATED; MULTI-PARTY ACCOUNT ACT REQUIRES CLEAR AND CONVINCING EVIDENCE TO NEGATE NET CONTRIBUTION RULE

In *Russell's Americinn, LLC v. Eagle General Contractors, LLC*, 2009 WL 2928544 (Minn. Ct. App. Sept. 15, 2009), the Minnesota Court of Appeals considered the district court's denial of a judgment debtor's exemption claims under Minnesota law following the garnishment of his Roth IRA account and a bank account held jointly with the judgment debtor's son.

First, the judgment debtor claimed that the funds in his Roth IRA account were exempt under Minn. Stat. § 550.37, subd. 24(a) which specifically listed IRAs and Roth IRAs as exempt accounts. The judgment creditor countered that funds in an IRA account are exempt only if they result from earnings, and this IRA account was funded by a rollover from an investment account and an inheritance.

Recognizing that the debtor bears the burden or proving an exemption applies, the court nonetheless reversed the district court's order finding that the clear, unambiguous language of Minn. Stat. § 550.37 required a finding that the IRA account was exempt. The court reasoned that if it had intended to include this limitation on exemptions, the legislature could have added language stating that funds in IRA accounts must arise from employment. The court also rejected respondent's contention that the statutory subheading "employee benefits" was determinative because the legislature directed that such headings are mere catchwords and not part of the statute.

Second, the judgment debtor claimed that the district court erred in finding that the joint bank account with his son was not exempt. The Multi-Party Account Act (MPAA) instructs that a joint account belongs to the parties in proportion to their net contributions, equal to the amount of money deposited by that individual less that person's withdrawals. Further, a joint account holder does not, without evidence of a contrary intent, own funds contributed by another party to the account. Although a joint account holder can withdraw such funds, he/she does so only with the consent of the contributing party.

The judgment debtor argued that the joint account was established to allow him to repay loans to his son. However, the appellate court deferred to the district court's factual finding that there was no clear evidence of such intent; only affidavits from the judgment debtor and his son.

BURDEN ON DEBTOR TO LIST NAME AND ADDRESS OF CREDITORS WHO MAY HAVE CLAIM, INCLUDING A MINOR AT THE TIME OF FILING

In the case of *Mitchell v. Bigelow (In re Mitchell)*, 418 B.R. 282, (8th Cir. BAP 2009), the B.A.P. held any claim based on the dischargeability exception for willful and malicious injury was time barred, however, the debtor was required to list the name and address of her creditor who was a minor at the time of filing as well as the relationship of some person who could accept service for that minor.

The debtor, Kathryn Bigelow, was once married to Daniel Mitchell, whose son, Benjamin Mitchell, was formerly Kathryn's stepson. While Kathryn and Daniel were married, Kathryn was involved in an altercation with her stepson, Benjamin. The incident led to an injury to Benjamin's arm and a permanent scar.

When Kathryn filed bankruptcy, she listed her ex-husband Daniel as a creditor. She listed his address, and for consideration, she listed "ex-husband." His name and address also appeared on Kathryn's creditor mailing matrix. Nowhere in her schedules did she list her former stepson Benjamin who was a minor at the time of her bankruptcy filing.

The complaint in this matter was filed over a year and a half after the deadline to file a complaint to determine dischargeability in Kathryn's case had passed. Benjamin sought to have any debt Kathryn incurred as a result of the assault upon him to be determined non-dischargeable pursuant to § 523(a)(6).

Section 523(a)(6) states that any debt incurred by the creditor as a result of a willful and malicious injury on the part of the debtor may be excepted from discharge provided that the creditor brings the claim before the bankruptcy court for determination as to whether the debt is dischargeable. Section 523(a)(6) requires that if the creditor is bringing a claim for non-dischargeability under that section, the creditor must bring suit before the deadline to file a claim to determine dischargeability has passed. Daniel missed that deadline.

Daniel argued however, that he could still bring suit despite having missed the deadline, because he was not properly scheduled as a creditor under § 521(a), and as such he did not receive notice nor did he have actual knowledge of Kathryn's bankruptcy as required for the creditor to be discharged under § 523(a)(3)(B).

Section 521(a)(1)(A) requires that Benjamin be listed as a creditor. Furthermore, Fed. R. Bankr. P. 1007(m) provides that if the debtor knows that a creditor is minor then the debtor must also list the name, address and relationship of a person who could accept service of process for that minor. Simply listing Benjamin's father Daniel was not enough. Kathryn was required to list the name and address of Benjamin, and Daniel's relationship to Benjamin. She did not.

The court held that Kathryn did not meet her burden of listing all of her creditors, including one that is a minor at the time of filing, in addition to a person who could accept service of process for said minor and that person's relationship to said minor. Thus, the B.A.P. reversed the bankruptcy court's order that Benjamin's claim was discharged.

JUDGMENT CREDITOR CAN EXCEPT FRAUD JUDGMENT SET TO EXPIRE FROM DISCHARGE, WHERE CREDITOR MERELY COMMENCES RENEWAL ACTION PRIOR TO EXPIRATION OF JUDGMENT

In *Swart v. Dahl (Dahl)*, Civ. Case No. 09-1255 (Sept. 25, 2009 D. Minn.) the district court upheld the bankruptcy court's order prohibiting discharge of a state-court fraud judgment against the debtors.

The plaintiff obtained a judgment in start court against the debtors for fraud, deceit and embezzlement. As the expiration of the ten-year term of the judgment approached, the plaintiff brought an action to renew the judgment in state court. After that action was commenced but before any judgment was issued, the debtors commenced this bankruptcy case. The issue presented is "whether a judgment creditor may obtain an exception from discharge for a state-court fraud judgment set to expire, where that creditor commences the renewal action before the expiration, but had not yet obtained relief in state court before the ten-year period had run." (Id. at *3). The court answered in the affirmative.

The court summarized the process for renewal of judgments, holding that a judgment creditor need only commence the action within the applicable time period to renew the judgment. The judgment need not be rendered and entered prior to its expiration. The court held that the renewed judgment does not give rise to a new claim; rather, it only extends the temporal life of the original judgment. Moreover, the court held that a renewal action constitutes a debt that may be excepted from discharge.

LEASE PAYMENTS FALLING DUE POST-PETITION ARE PRIORITY ADMINISTRATIVE EXPENSES EVEN IF FOR PRE-PETITION USE AND REGARDLESS OF NECESSITY TO PRESERVE ESTATE

In *Roehrich v. Burival (In re Burival)*, No. 08-6026 (8th Cir. BAP June 4, 2009), the Bankruptcy Appellate Panel made several critical legal holdings regarding the treatment of unexpired non-residential leases in bankruptcy. The lease at issue was a crop land lease, which required debtor to make his final bi-annual rental payment of $90,799.33 only two days after he filed for bankruptcy. The court found that the debtor in possession was legally responsible for payment of the full amount to landlord, even though the payment related to pre-petition usage of the property for the prior six months.

Section 365(d)(3) of the Bankruptcy Code requires a trustee or a Chapter 11 debtor in possession to perform all obligations under an unexpired non-residential lease until the lease is rejected for a period of up to sixty days. The court held that the debtor is responsible for rental payments becoming due in the sixty days, even if that obligation primarily accrued prior to the sixty days. The timing of when the payment comes due is essential, not the timing as to when the obligation accrues.

The court also found that if the landlord is not paid in full it may file an administrative claim for the amount owed under Section 503(b)(1). The administrative claim will require payment in full otherwise the debtor likely cannot confirm a plan of reorganization. The court also found that landlords can assert the administrative claim without first establishing that the rent obligation "was an actual and necessary cost or expense of preserving the bankruptcy estate," as required for most administrative claims. While this case involved a crop land lease, the court's analysis of Section 365(d)(3) presumably applies to all unexpired non-residential leases in bankruptcy.

DEBTOR'S FAILURE TO DISCLOSE OTHER INTENDED PERSONAL USE OF LOANED FUNDS IS ACTUAL FRAUD GROUNDS FOR NON-DISCHARGEABILITY

In the case of *Fee v. Eccles (In re Eccles)*, No. 08-6028 (8th Cir. BAP June 8, 2009), the BAP affirmed a bankruptcy finding of non-dischargeability where a debtor procured a loan by false representation under §523(a)(2)(A). In this case, the debtors purchased several properties in Missouri with the intent to renovate the properties for resale. The debtors did not have sufficient money to complete the renovations. Prior to starting the renovations, they had met the plaintiffs, the Fees, who agreed to lend them approximately $20,000 per house to complete renovations for a total of $120,000, the amount required to complete six properties.

The trial court found that rather than paying for renovations, the debtors used the

funds for general living expenses, including health insurance, mortgage payments on personal properties, automobile loans, childcare, toys for their children, eating out, groceries, and a new roof on their residential property.

The bankruptcy court found debtors' acts were non-dischargeable under 523(a)(2)(A), which provides that a debt can be non-dischargeable due to the actual fraud of a debtor in obtaining credit by "false pretenses, false representation, or actual fraud, other than a statement respecting the debtor's or insider's financial condition." To prove actual fraud, creditor must show, (1) the debtor made a false representation; (2) at the time the representation was made, the debtor knew it was false; (3) the debtor subjectively intended to deceive the creditor at the time it made the representation; (4) the creditor justifiably relied upon the representation; and (5) the credit was damaged.

The debtors' false statement in this case was failing to disclose that renovating the properties was not the only intended purpose for the loan, and that the loan proceeds would be used for living expenses. Silence regarding a material fact can constitute a false representation. The most difficult prong to prove in this type of case is showing debtors' intent to misappropriate the proceeds at the time of the loan. If debtor had not consciously decided to misappropriate the funds before receiving the loan, the subsequent misappropriation would not qualify for a non-dischargeable finding under the actual fraud prong of 523(a)(2). In this case, however, the court did find sufficient evidence of intent of deceit at the time debtors' agreed to the loan. The court relied heavily on the fact debtors only spent $14,000 out of the loan proceeds of $120,000 towards the project, and that in the first month on the project debtors had spent approximately $18,000 on personal expenses and $13,000 on the project. Debtors had previously represented to Debtors that the project would cost $120,000, the full amount of the loan proceeds.

The Eccles case provides some framework for the type of factual record required to show non-dischargeability for non-payment of a loan. The case also presents a framework for a non-dischargeability claim based on fraud where a contractor on a construction project may commit theft of construction proceeds, which has always been a difficult claim to prove in the bankruptcy court.

B.A.P. FINDS STATE LAW DEETERMINES WHAT PROPERTY IS EXEMPT, BUT FEDERAL LAW DETERMINES IF A LIEN ON PROPERTY CAN BE AVOIDED

In *Cleaver v. Warford (In re Cleaver)*, Case No. 08-6052 (B.A.P. 8th Cir. May 13, 2009) (J. Kressel), the B.A.P. reversed the Iowa bankruptcy court ruling that state law only determines what property a debtor can claim as exempt, but not the availability of lien avoidance under 11 U.S.C. § 522(f).

In the *Cleaver* case, before the Debtors filed for bankruptcy, they granted a creditor a security interest in a semi-tractor truck the Debtors already owned. After filing for Chapter 13 bankruptcy, the Debtors claimed an exemption for the truck as a motor vehicle under Iowa state law. Although no objection was made to the exemption, the Trustee later objected to the Debtors' motion to avoid the nonpossessory, nonpurchase-money security interest lien in the truck under 11. U.S.C. § 522(f)(1)(B)(ii) as a "tool of the trade." Because Iowa has opted out of the federal bankruptcy exemptions, and Iowa law is split on

whether a vehicle can be a "tool of the trade," the Iowa bankruptcy court ruled that since this truck could not be a tool of the trade under Iowa law the Debtor could not avoid a lien in the truck under the tool of the trade provision of § 522(f).

The B.A.P., however, reversed, finding that state law is used only to determine what property can be exempt, and then federal law determines if a lien in property can be avoided. The court reasoned that exemption protection is different from the protection provided by avoiding a lien. The Bankruptcy Code specifically provides protection for avoiding liens which could be an essential step to a debtor's rehabilitation and fresh start because it eliminates a creditor's unfair advantage, especially against unsophisticated consumers. This special protection provided by federal bankruptcy law means that it should be available to property fitting certain definitions under federal, and not state, law.

Therefore, regardless of how "tool of the trade" is defined under state law, certain property could qualify for lien avoidance under § 522(f) based on the federal law definition, even if it is not considered a tool of the trade under applicable state law. The Cleaver case was reversed and remanded so the Debtors could have a chance to prove that the truck fits the federal law definition of "tool of the trade" set forth by the 8th Circuit in *Production Credit Association of St. Cloud v. LaFond (In re LaFond)*, 791 F.2d 623, 627 (1986).

REVERSE CORPORATE PIERCING DOCTRINE CANNOT BE USED TO SAVE DENNY HECKER LAKE HOME

In *In re Hecker*, No. 09-50779 (Bankr. D. Minn. Sept. 25, 2009) Judge Kressel refused to allow Debtor Dennis Hecker to claim a homestead exemption on property Hecker lived in as a residence just prior to filing for bankruptcy but did not own in his name.

The homestead exemption is available on property that a debtor both lives in and owns. In his schedules, Hecker claimed a homestead exemption under Minnesota state law for property located in Cross Lake, Minnesota, where he lived just before filing for bankruptcy. The Cross Lake property is owned by Jacob Holdings of Cross Lake LLC, a limited liability company wholly owned by Jacob Properties of Minnesota LLC, a limited liability company which Hecker is the owner of substantially all the interests. Even though Hecker was not the title owner of the property he argued that he was the true owner under the theory of "reverse corporate veil piercing," or a disregard of the legal concept that a company is an entity distinct from the company's owner. He argued that since he is the majority interest holder in the company holding title, he therefore is the alter ego of the company and the true owner of the property for purposes of the homestead exemption.

Minnesota has allowed reverse veil piercing, in several limited circumstances when equity so required. In *Cargill v. Hedge*, a family farmer that incorporated and put the farm in the corporation's name was allowed to claim the homestead exemption because the court found that it would be unfair if the family was denied the exemption they otherwise would have had but for incorporation. 375 N.W.2d 477, 478-80 (Minn. 1985). Similarly, the corporate identity was disregarded for another family farming corporation that was found to be the alter ego of the family corporate owners. *State Bank in Eden Valley v. Euerle Farms, Inc.*, 441 N.W.2d 121, 124 (Minn. App. 1989). Even with these rare cases, the Minnesota Supreme

court stated that reverse piercing should only be permitted in very limited circumstances. *Hedge*, 375 N.W.2d at 480. Under Minnesota law, courts look at 2 factors when deciding if reverse piercing is appropriate: (1) the relationship between the individual and the entity and if the entity is an alter ego of the individual, and (2) if creditors or other owners would be harmed if piercing is permitted.

Although Minnesota has allowed reverse piercing in some special situations, the court in Hecker found that Hecker did not meet the Minnesota requirements. Even though there is clearly evidence that Hecker was basically the sole owner of the company that held title to his Cross Lake residence, he did not show any other factors that indicate the limited liability companies he set up were his "alter egos." For example, Hecker failed to produce evidence that the companies were undercapitalized, did not observe corporate formalities, nonpayment of dividends, siphoning of funds from company to Hecker, or nonfunctioning offices and directors. Instead, Hecker's limited liability companies owned many non-residential investment properties, and payments for the Cross Lake residence were made from advances from the company to Hecker.

Hecker also failed to show that creditors would not be harmed if the corporate veil is pierced. The court noted that several creditors extended credit to Hecker personally and to his limited liability companies. Since homestead exemptions are permitted for individuals only, creditors of the companies would not expect a corporate entity to claim the exemption, and therefore should not be harmed by an unexpected exemption.

Finally, the court found that Hecker did not show it would be unfair or unjust if the veil is not pierced. Instead, the facts persuaded the court that reverse veil piercing was not appropriate. For example, the Cross Lake home was a seasonal property, and only Hecker's residence on the eve of his bankruptcy filing; the property was not homesteaded for property tax purposes; and the limited liability companies owned many investment properties.

BANKRUPTCY COURT HAS SUBJECT MATTER JURISDICTION OVER STATE LAW CLAIMS WITH ANY "CONCEIVABLE EFFECT" ON DEBTORS' ESTATE

In *GAF Holdings, LLC vs. Rinaldi et al. (In re Farmland Industries, Inc.),* No. 07-3840 (8th Cir. June 10, 2009), the Eighth Circuit reversed a BAP decision and held that 28 U.S.C. 157(c)(1) gives a bankruptcy court subject matter jurisdiction over any state law claims "related to" a bankruptcy case. In so holding, the Eighth Circuit stated that the test for "related to" jurisdiction is whether the outcome of a proceeding could "conceivably have an effect on the estate being administered in bankruptcy".

This appeal arises out of a dispute over assets sold in the Chapter 11 bankruptcy case of Farmland Industries, Inc. ("Farmland"). Prior to the bankruptcy, Appellee-GAF Holdings, LLC ("GAF") had offered to purchase certain assets from Farmland (the "Coffeyville Assets"). The original sale transaction fell through, however, when GAF failed to obtain necessary financing. The Coffeyville Assets were later sold in a Section 363 sale in the Farmland bankruptcy case. The Appellants include the successful bidders for the Coffeyville Assets (the "Pegasus Defendants") and two former officers of Farmland (the "Former Officers"). GAF did not object to or appeal from the bidding procedures motion, Farmland's determination that GAF was not a qualified

bidder, or the order approving the sale of the Coffeyville Assets to the Pegasus Defendants.

Three years after the sale of the Coffeyville Assets to the Pegasus Defendants closed, GAF filed a complaint in the bankruptcy court alleging several state law causes of action, including civil conspiracy between the Pegasus Defendants and the Former Officers ("GAF's Complaint"). The bankruptcy court dismissed GAF's Complaint on multiple grounds. GAF appealed to the BAP, which held *sua sponte* that the bankruptcy court lacked subject matter jurisdiction over GAF's Complaint.

The Eighth Circuit reversed the BAP, holding that the state law claims set forth in GAF's Complaint were "related to" the Farmland bankruptcy case, giving the bankruptcy court subject matter jurisdiction under 28 U.S.C. 157(c)(1). Notwithstanding the fact that the litigation between GAF and the Pegasus Defendants did not directly involve the debtors, the Eighth Circuit explained that the outcome of the litigation could have a "conceivable effect" on the Farmland estate because it was liable to the Former Officers under an indemnification agreement.

BANK VIOLATED AUTOMATIC STAY IN FAILING TO TAKE ACTION TO STOP AUTOMATIC LOAN PAYMENTS FROM DEBTOR'S BANK ACCOUNT

In *Krivohlavek v. Boys Town Federal Credit Union*, 405 BR 312 (B.A.P. 8th Cir. 2009), the B.A.P. reversed the order of the Nebraska bankruptcy court denying the debtor's motion for turnover and sanctions against a creditor for alleged violations of the automatic stay and remanded to the bankruptcy court for a determination and imposition of sanctions against the creditor.

Debtor's Chapter 7 petition included a statement of intention indicating she would surrender a vehicle that was collateral for her loan to Boys Town Federal Credit Union ("Credit Union"). Before filing, the debtor made payments to the Credit Union through an automatic payroll deduction through her employer.

The debtor sought turnover of funds from the Credit Union that were automatically deducted from her paycheck after the bankruptcy filing in violation of the automatic stay. The debtor alleged the Credit Union had notice of the bankruptcy filing because it was listed in her creditor matrix and because she gave the Credit Union notice by telephone and in writing that she intended to surrender the vehicle and demanded that the automatic deductions stop. The Credit Union argued that only the debtor, not the Credit Union, had the ability to stop the automatic deduction, stating that the debtor must complete a written form and submit it to her employer. A few months after the petition date, the debtor submitted the form to stop the deductions, but until that time, $1,875.86 was automatically deducted and the Credit Union had applied $1,315.86 to repayment of the loan. Shortly thereafter, debtor received her discharge, the case was closed. Two months later, debtor surrendered the vehicle to the Credit Union.

Eight months after the bankruptcy case was closed, the debtor requested that the case be reopened for the purpose of filing the motion for turnover and sanctions against the Credit Union. The bankruptcy court reopened the case, but denied the debtor's motion and debtor appealed. The court reasoned that it was the debtor, not the Credit Union, that had the sole ability to stop the automatic deductions and that the Credit Union was justified in keeping the

funds because debtor had not yet surrendered the vehicle despite indicating her intent to do so.

In its decision, the B.A.P. focused on the mechanism of the automatic payroll deduction and the manner in which the Credit Union applied the debtor's payments to the loan balance. The Credit Union argued that the automatic deduction and the application of payments was a one-step transaction, of which only the debtor had control to stop. The Credit Union contended that it could not have violated the automatic stay because it did not take any affirmative act to collect the debt from the debtor, as prohibited by 11 U.S.C. § 362(a). The debtor asserted that the automatic deduction and application of payments was a two-step process, because the funds were first deposited into her account and then the Credit Union applied a percentage of those funds to the loan which was an affirmative act to collect a debt in violation of 11 U.S.C. § 362(a). The debtor also argued that even if she had the ability to stop the automatic deduction by completing the form, the Credit Union had the ability to stop the application of funds from the debtor's savings account to the loan.

The B.A.P. held that payment of the loan was a two-step process of which the Credit Union affirmatively collected a debt in violation of the automatic stay. The B.A.P. reversed and remanded to the bankruptcy court for entry of a turnover order and a determination of the appropriate sanctions, including debtor's attorneys' fees in pursuing the motion and appeal.

ABSTENTION WARRANTED IN DEBTOR'S ADVERSARY PROCEEDING FOLLOWING ADVERSE RULING IN STATE COURT ACTION INITIATED BY DEBTOR

In *Stabler v. Beyers*, 418 BR 764 (B.A.P. 8th Cir. 2009), the B.A.P. affirmed the order of the South Dakota bankruptcy court abstaining from exercising jurisdiction over an adversary proceeding based upon the collateral estoppel effect of a prior state court judgment and on a determination that permissive abstention was warranted under 28 U.S.C. § 1334(c)(1).

Debtors filed a Chapter 7 bankruptcy petition and listed a $225,000 bank debt in their schedules which was secured by personal property valued at $216,000.

Following their discharge, debtors entered into two transactions to repay certain pre-petition secured debt. After debtors defaulted on the loans, debtors filed a lawsuit alleging the debts were discharged in bankruptcy. The lender answered the complaint and counterclaimed for breach of the notes, foreclosure of the security interest, and for entry of deficiency judgments against debtors for only the amounts not discharged in bankruptcy. While the lender sought summary judgment in state court, debtors filed an adversary proceeding in their bankruptcy case alleging the lender's state-court claims violated the discharge injunction. Meanwhile, the state court held that the bankruptcy discharge only affected debtors' personal liability, not the security interests or liens; therefore, the lender was entitled to summary judgment on its claims.

The lender then sought to dismiss debtors' adversary complaint using collateral estoppel, or in the alternative, abstention pursuant to 28 U.S.C. § 1334(c)(1). The bankruptcy court abstained from exercising jurisdiction over the debtors' adversary proceeding and the debtors appealed.

The B.A.P. examined the bankruptcy court's authority to abstain from exercising its jurisdiction over a proceeding pursuant to

28 U.S.C. § 1334(c)(1) and articulated the criteria that courts have developed to determine whether abstention is warranted. The B.A.P. listed the specific criteria, including: (1) the effect or lack thereof on the efficient administration of the estate if the court recommends abstention, (2) the extent to which state law issues predominate over bankruptcy issues, (3) the difficult or unsettled nature of the applicable law, (4) the presence of a related proceeding commenced in state court or other nonbankruptcy court; (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334, (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case, (7) the substance rather than the form of an asserted "core" Proceeding, (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court, (9)the burden on the bankruptcy court's docket, (10) the likelihood that the commencement of the proceeding involves forum shopping by one of the parties, (11) the existence of a right to a jury trial, and (12) the presence in the proceeding of nondebtor parties.

The bankruptcy court determined the majority of these factors weighed in favor of abstention and the B.A.P. agreed, noting that the forum shopping factor deserved special consideration because debtors had commenced a state court case and then filed an adversary proceeding only after the state court ruled against them. The B.A.P. concluded the state court had jurisdiction to determine whether debts were discharged, and affirmed the bankruptcy court's order abstaining from exercising jurisdiction.