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Refunded Amounts Not Included When Aggregating the Dollar Amount of Transfers under 11 U.S.C. § 547(c)(8)

Pierce v. Collection Associates, Inc. (In re Pierce), No. 14-1365 (8th Cir. March 9, 2015) involved an appeal of issues relating to pre-petition garnishment and the aggregation of dollar amounts of allegedly-preferential transfers under 11 U.S.C. § 547(c)(8). The debtor's employer sent the first four garnishments, which totaled $562.78, to the state court that had issued the garnishment order. The state court in turn delivered those garnished funds to the creditor. The debtor and his wife then filed their bankruptcy petition and notified the state court. The state court later received the final two garnishments, which totaled $296.20, but rather than delivering those funds to the creditor, it returned the money to the debtor's employer, which then refunded the money to the debtor.

The debtor commenced an adversary case seeking to avoid and recover $562.78 from the creditor. The parties agreed that all elements of section 547(b) were satisfied, but disagreed as to the application of the defense for consumer debtor payments. Section 547(c)(8) provides that the trustee may not avoid a transfer under section 547 "if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $600." 11 U.S.C. § 547(c)(8).

The debtor argued the defense did not apply because the total amount of the wages garnished and transferred to the creditor during the preference period was $858.98, which exceeded the $600 limit for the defense. According to the debtor, it was irrelevant that the creditor actually received less than $600 due to the return of the two final garnishments by the state court. The bankruptcy court dismissed the complaint after finding the aggregate value of all property affected by the transfer was less than $600, and the Eighth Circuit BAP affirmed. The debtor appealed.

The Eighth Circuit affirmed, reasoning it could not overlook the fact that the state court had returned the final two

garnishments. As a result, the complaint only sought the return of $562.78 – the amount of the first four garnishments. Since the debtor sought to avoid only the first four garnishments, the aggregate value of which was less than $600, the Eighth Circuit held that the section 547(c)(8) defense for consumer debtor payments applied.

Eighth Circuit Requires State to Return Unauthorized Taxes Collected on Wagering to the Bankruptcy Estate

In *PW Enterprises, Inc. v. State of North Dakota (In re Racing Services, Inc)*, No. 14-1077 (8th Cir. February 20, 2015), the debtor was a licensed simulcast service provider responsible for paying required taxes to the state. Creditor used the debtor's services to place a high volume of parimutuel wagers on horse races. Its bets were very successful and at the time of the bankruptcy filing, creditor's account balance with the debtor exceeded $2.2 million. In the year preceding the bankruptcy filing, the state collected in excess of $5 million in taxes from the debtor and additionally, the state submitted a proof of claim in the case exceeding $6.4 million. Creditor (the debtor's largest non-governmental creditor) obtained derivative standing and brought an adversary proceeding against the state, seeking to disallow the state's claim, deny priority to the state's claim, avoid and recover preferential and fraudulent transfers, and to equitably subordinate the state's claim.

On cross-motions for summary judgment, the bankruptcy court ruled in favor of the state, concluding that the statute authorized taxation on account wagering. The district court reversed. The state appealed, and the Eighth Circuit affirmed.

At issue before the Eighth Circuit was whether state law impliedly authorized the state to collect taxes from the debtor pre-petition even though there was no direct legislative authority to do so. Acknowledging the clear and unambiguous meaning of the statute and the absence of any legislative action, the state urged the Eighth Circuit to infer an implied tax on account wagering. The Eighth Circuit declined, affirmed the district court, and remanded the case to the bankruptcy court to calculate the amount of unauthorized taxes the state must return to the estate.

The Eighth Circuit reasoned that taxation is a legislative function, and courts may not substitute their judgment for that of the legislature. The Eighth Circuit made clear it would not "correct an alleged legislative 'oversight' by rewriting unambiguous statutes to cover the situation at hand."

Orders Denying Confirmation Are Not Final Orders

In the case of *In re Civic Partners Sioux City, LLC*, No. 13-3636 (8th Cir. Mar. 3, 2015), the Eighth Circuit repeated long-standing Eighth Circuit case law that an order denying plan confirmation is not a final order, and therefore cannot be appealed. The debtor, the lessor of a movie-theater complex in Sioux City, Iowa, filed a plan of reorganization. The plan depended on the subordination of certain claims and setting aside an amendment to the lease due to an alleged fraud by the debtor’s lender and the city of Sioux City. The bankruptcy court issued two orders deciding that the amended lease was enforceable. The Eighth Circuit BAP dismissed the debtor’s appeal because it was interlocutory. The debtor

then filed a second plan, which the court refused to confirm. The BAP again dismissed the debtor's appeal, leaving four separate orders for which the debtor sought review by the Eighth Circuit. The Eighth Circuit dismissed the appeal, holding that an order denying plan confirmation is not a final order, and therefore cannot be appealed. As for the earlier orders, they were either non-final orders and therefore cannot be appealed, or the time to appeal – 30 days – had long passed. Note that the Supreme Court recently reached the same conclusion, resolving a circuit split on this issue. *Bullard v. Hyde Park Savings Bank*, 575 U.S. ____ (2015).

Estates of Married Couple Substantively Consolidated Where Affairs Were Interrelated and Creditors Would Be Harmed by Separate Estates

The case of *Boellner v. Dowden*, No. 14-2816 (8th Cir. May 12, 2015), involved a bankruptcy court's decision to substantively consolidate the chapter 7 cases of a married couple who had filed separate petitions for relief. The debtors asserted they filed separate cases to allow the husband to claim federal exemptions and the wife to claim state exemptions, a selection that would not be possible in a joint case. The trustee and several creditors argued that the debtors were improperly trying to "stack," or double-up, their exemptions. The bankruptcy court, after considering whether the debtor's financial affairs were substantially interrelated and the relative harm to the debtors and creditors of each option, ordered that the cases be consolidated and jointly-administered. On appeal, the Eighth Circuit Court of Appeals applied a test from *In re Reider*, 31 F.3d 1102, 1108 (11th Cir. 1994): "In assessing the propriety of substantive consolidation, a court must determine: (1) whether there is a substantial identity between the assets, liabilities, and handling of financial affairs between the debtor spouses; and (2) whether harm will result from permitting or denying consolidation." It reviewed the evidence and affirmed, holding that the bankruptcy court did not abuse its discretion.

Stern Claims Can Be Adjudicated by the Bankruptcy Court with the Parties' Knowing and Voluntary Consent

In *Wellness International Network, Limited v. Richard Sharif*, No. 13-935 (S. Ct. May 25, 2015), the United States Supreme Court considered whether Article III allows bankruptcy judges to adjudicate *Stern* claims with the parties' consent.

Wellness International, the creditor, had claims against the debtor arising out of a judgment. The creditor filed an adversary proceeding objecting to the debtor's discharge and seeking a declaratory judgment that a trust that owned assets was the debtor's alter ego and therefore, the trust assets belonged to the debtor's bankruptcy estate. The creditor alleged that the proceeding was a core proceeding in which the bankruptcy court could enter final judgment. The debtor admitted that the proceeding was a core proceeding in his answer. The bankruptcy court entered a judgment in the creditor's favor, denying the debtor's discharge and declaring the trust assets were part of the bankruptcy estate.

The debtor appealed to the Seventh Circuit. *Stern* was decided before the debtor's briefing was due, but he failed to raise it. The Seventh Circuit held that an argument concerning the constitutional authority of

the bankruptcy court could not be waived. The Seventh Circuit decided that the bankruptcy court lacked constitutional authority to enter a final judgment as to whether the trust property should be included in the debtor's bankruptcy estate. The court also ruled that the parties could not consent to final adjudication by a bankruptcy court.

The United State Supreme Court reversed, holding that Article III is not violated when parties knowingly and voluntarily consent to adjudication by a bankruptcy judge. The Court acknowledged the important service rendered by non-Article III judges in the administration of legal proceedings. The Court reasoned that "[a]djudication by consent is nothing new." The Court also explained that adjudication by non-Article III judges does not threaten the separation of powers and the integrity of the judiciary because Article III judges have supervisory capacity with respect to non-Article III courts.

Potential Future Liability Does Not Create Standing to Appeal Where Appellant Has No Other Financial Stake in the Outcome

In *Westlb Ag v. Douglas Kelly*, No. 13-CV-3611 (D. Minn. April 23, 2015), the district court considered whether four groups of lenders had standing to appeal a bankruptcy court order that substantively consolidated nine bankruptcy estates related to the Petters Company, Inc. bankruptcy.

The appellants were lenders (and "net winners" of the Petters Ponzi scheme) who extended financing to eight special-purpose entities wholly-owned and controlled by the Petters Company or Thomas Petters.

The trustee argued that the appellants lacked standing under the "person-aggrieved" doctrine because they did not have a financial stake in the outcome of the dispute. The appellants argued in response that the trustee should be estopped from raising the standing issue because the trustee had previously argued that the court had jurisdiction over the appeal.

The district court reasoned that: (a) the trustee's earlier position regarding standing was not clearly inconsistent with his current position that the appellants lack standing; (b) the trustee's failure to raise standing earlier was inadvertent – and at the time of the earlier argument there was one appellant who had standing; and (c) there is little prejudice to the appellants as they were only required to undergo one round of unnecessary briefing. The district court also held that the appellants did not have standing to appeal because that their only relevant interest - i.e., avoiding liability in the consolidated bankruptcy cases - did not constitute the type of interest needed to establish standing.

BAP affirms Bankruptcy Court Order for Relief from Stay Based on Debtors' Equitable Interest in Vehicle

In *Gess and Garza v. Randolph Brooks Federal Credit Union (In re Gess;Garza)*, No. 14-6045, (8th Cir. BAP March 18, 2015), the debtors filed a joint *pro se* Chapter 7 bankruptcy case. Lender filed a motion for relief from stay regarding a vehicle, which was owned by the debtor's father but in the debtor's possession. The debtors opposed the motion.

The debtors made three primary arguments as to why relief from stay should not be

granted: (i) they did not have an ownership interest in the vehicle, (ii) the credit union's lien was not enforceable against them, and (iii) the credit unions interest was adequately protected despite the fact that regular payments were not being made because the vehicle was insured. The vehicle’s certificate of title listed the debtor’s father as the sole owner. Under 11 U.S.C. §541, however, property of the bankruptcy estate is broadly defined as “all legal or equitable interests of the debtor in property as of the time of the commencement of the case.” Because the debtor’s father was deceased at the time of the bankruptcy filing and the debtor was the sole designee under his will, the bankruptcy court concluded the debtor had at least an equitable interest in the vehicle. The bankruptcy court also held the lender’s interest was evidenced by the security agreement signed by the debtor’s father and the lien was noted on the certificate of title, therefore the lender had a perfected security interest in the vehicle. Finally, the bankruptcy court held that, because vehicles decline in value quickly due to use, regular payments are typically required in addition to insurance coverage to adequately protect creditors.

The bankruptcy court granted the lender's motion and the debtors appealed. The bankruptcy court’s decision was reviewed under an abuse of discretion standard and the Eighth Circuit BAP affirmed based on the debtors' failure to show that the bankruptcy court abused its discretion.

Additional Child Tax Credit (ACTC) Meets the Exemption Requirement for a Public Assistance Benefit under Missouri Law

In *Hardy v. Fink (In re Hardy)*, No. 14-1181 (8th Cir. June 2, 2015), the debtor sought to exempt a portion of her tax refund attributable to the Additional Child Tax Credit (ACTC) from her bankruptcy estate. The debtor asserted that the refundable credit qualified as a public assistance benefit under Missouri’s schedule of exemptions. The trustee objected, and the bankruptcy court sustained the objection. The Eighth BAP affirmed, and the Eighth Circuit reversed.

Missouri opted out of the federal exemptions and employs its own statutory bankruptcy exemptions under Missouri law. Missouri exempts “public assistance benefits” from bankruptcy estates. Mo. Rev. §513.430.1(10)(a). The Missouri exemption schedule does not expressly define “public assistance benefit,” but the Missouri legislature has defined the term in other sections of the Missouri code. After analyzing other references to the term, and otherwise examining the Missouri legislature's intent, the Eight Circuit concluded that Missouri's ACTC is a “public assistance benefit.”

The Eighth Circuit's decision is consistent with a number of bankruptcy courts that have addressed the issue. In both the Central and Northern District of Illinois, the ACTC was found to be an exempt public assistance benefit. Most recently an Iowa bankruptcy court also held the ACTC to be an exempt public assistance benefit. Other courts have disagreed with these conclusions but these courts addressed only the CTC and ACTC as it was originally enacted as opposed to the legislation as a whole, including all amendments.

Polaroid Estate Still Entitled to Proceeds of a License Agreement That Was Sold to a Third Party

In *Stoebner v. PNY Technologies, Inc.*, No. 14-CV-137 (D. Minn. April 23, 2015), the district court adopted the bankruptcy court's Report and Recommendation finding that no genuine issues of material fact exist regarding the ability of the trustee, to recover unpaid royalties under a license agreement.

PNY Technologies and the debtor entered into a brand license agreement pursuant to which PNY agreed to pay royalties to the debtor for the use of various of the debtor's trademarks. PNY used the trademarks and owed royalties as a result, but PNY failed to pay the royalties in full.

The trustee filed an adversary proceeding seeking to recover the unpaid royalties. The parties filed cross-motions for summary judgment on the trustee's claims. The bankruptcy court issued a Report and Recommendation recommending that PNY's motion be denied and the Trustee's motion be granted. The bankruptcy court recommended that judgment be entered in an amount equal to the unpaid royalties, less the amount of PNY's claim against the debtor in the main bankruptcy case arising from the debtor's breach of a different contract between the parties.

PNY objected to the Report and Recommendation. PNY argued that the trustee had no legal right to the unpaid royalties. PNY argued that according to the terms of an asset purchase agreement entered into by Polaroid and a third-party, Polaroid had sold its rights under the brand license agreement, including its right to payment of the royalties. However, the district court determined that, based on the terms of the asset purchase agreement, the right to royalties "due and owing under the Acquired Contracts and accruing on or before the Closing Date" were retained by the debtor. And, as a result, the trustee was entitled to assert a claim for pre-sale unpaid royalties.

The Minnesota Supreme Court Holds that No Ponzi Presumption Exists under Minnesota Law

In *Finn v. Alliance Bank*, Case Nos. A12-1930, A12-2092 (Minn. Feb. 18, 2015), the Minnesota Supreme Court affirmed a decision of the state court of appeals, holding that the Minnesota Uniform Fraudulent Transfer Act ("MUFTA") does not contain a "Ponzi-scheme presumption" and that the limitations period applicable to MUFTA claims based on actual fraud is governed by Minn. Stat. § 541.05, subd. 1(6).

First United Funding, LLC sold loan participations to various financial institutions. First United also operated a so-called Ponzi scheme whereby it oversold participation interests, and also sold fictitious participation interests. As the scheme unraveled, various lenders sued First United, seeking, among other relief, the appointment of a receiver to liquidate First United's assets. Notably, the lenders involved at the time *Finn* was decided each purchased participation interests in real loans made to actual borrowers.

The district court appointed a receiver and authorized it to pursue claims against third-parties. The receiver filed claims against several lenders that participated in loans that had been repaid, including several lenders that only purchased participated interests prior to six years before the lawsuit

("Respondent Banks"). The receiver also filed claims against Alliance Bank, which purchased participated interests both earlier than, and after six years before the lawsuit. The amounts paid to the Respondent Banks and Alliance included both principal and interest. The receiver asserted, among other things, that the transfers of amounts in excess of the principal were actually fraudulent and constructively fraudulent transfers under MUFTA.

The Respondent Banks and Alliance moved to dismiss the receiver's MUFTA claims as time-barred. The district court held that the six-year limitations period under Minn. Stat. § 541.05, subd. 1(2) applied to both actually fraudulent and constructively fraudulent transfer claims. As a result, the district court dismissed all claims asserted against the Respondent Banks. Because the receiver sufficiently pleaded its MUFTA claims against Alliance, the district court allowed claims to proceed against Alliance that related to transfers made within six years prior to the lawsuit.

The receiver appealed the district court's dismissal of its claims against the Respondent Banks. Alliance appealed the district court's application of a "Ponzi-scheme presumption."

The receiver's appeal was affirmed in part, but the district court's finding that the receiver's claims based on actual fraud were "relief on the ground of fraud, " and thus subject to Minn. Stat. sec. 541.05, subd. 1(6), was reversed. With respect to Alliance's appeal, the court of appeals determined that, although two of the three components of the "Ponzi-scheme presumption" apply to claims under MUFTA, the third component did not. As a result, the court of appeals reversed the district court and directed entry of judgment in favor of Alliance.

The cases were then appealed to the Minnesota Supreme Court. The court first addressed whether the "Ponzi-scheme presumption" applied to claims asserted under MUFTA. It held that it does not. The court explained that the presumption actually consists of three separate presumptions: fraudulent intent is presumed under an actual fraud claim, and insolvency and lack of reasonably equivalent value are presumed under a constructively fraudulent claim.

With respect to the first component, the court noted that MUFTA does not reference or define the term "Ponzi scheme," and that the statute does not focus on patterns of transactions typically seen in Ponzi scheme scenarios. Instead, the court found that MUFTA focuses on individual transfers made by debtors.

With respect to the second component, the court determined that MUFTA requires a finding of insolvency for constructively fraudulent transfers *at the time* of the transfer. MUFTA does not provide for a blanket presumption of insolvency in the event of a Ponzi scheme, primarily because it is possible, in some circumstances that the debtor either began the business in a legitimate manner or operated a Ponzi scheme concurrently with a legitimate business (which occurred in this case).

With respect to the third component, the court interpreted MUFTA's definition of "value" to include the satisfaction of any legally-enforceable right to payment against the debtor. Because the lenders' rigths to the payments they received from First United

were based on legitimate participation agreements, the court determined that the presumption asserted by the receiver could not stand because the payments could constitute the repayment of a valid, enforceable debt.

As a result of its rejection of the "Ponzi-scheme presumption," the court determined that the receiver could not rely upon the presumption in pleading its fraudulent transfer claims under MUFTA.

Eighth Circuit Rules that Untimely Intervention Motion Precludes Standing to Appeal Denial of Other Motions

In *Stephens v. Living Hope Southeast, LLC (In re Living Hope Southwest Medical Services, LLC)*, No. 14-2926 (8th Cir. Mar. 31, 2015), the bankruptcy court denied the appellant's motions to intervene, to reconsider, and to grant a new trial, principally because appellant's intervention motion was simply untimely. The district affirmed and appellant appealed.

The Eighth Circuit affirmed as to the motion to intervene, and concluded that as a consequence of being precluded from becoming a party in the case, appellant lacked standing to appeal the orders denying his other motions.

Individual Retirement Annuity Complied with Applicable Requirements and Was Completely Exempt

In *Running v. Miller (In re Miller)*, No. 13-3682 (8th Cir. Feb. 13, 2015), the Eighth Circuit affirmed decisions of the BAP and bankruptcy court holding that an annuity derived from an individual retirement account owned by the debtor was fully exempt.

The debtor purchased the annuity with a lump-sum payment of approximately $267,000 using funds from an individual retirement account. The annuity was to make annual payments of more than $40,000 each to the debtor for the eight consecutive years. The debtor later filed a petition for relief pursuant to Chapter 7 of the Bankruptcy Code. On his schedules, the debtor claimed the entire annuity was exempt pursuant to 11 U.S.C. § 522(b)(3)(C), which exempts retirement funds to the extent they are in an account exempt from taxation under section 408 Internal Revenue Code.

Section 408 of the IRC exempts from taxation individual retirement accounts and individual retirement annuities. This exemption generally applies even if the debtor transferred the retirement funds to the qualified retirement plan from another qualified retirement plan. 11 U.S.C. § 522(b)(4)(C).

The trustee objected the claimed exemption, asserting the debtor's annuity was not a qualified individual retirement annuity because it failed to comply with two statutory requirements: (1) that the premium not be fixed, and (2) that the annual premium not exceed $6,000 for the taxable year in question. The trustee argued the debtor's premium was fixed because he made the purchase payment in a lump sum and that the amount of the purchase exceeded the statutory maximum.

The Eighth Circuit determined the annuity to be exempt, drawing a distinction between rollover funds and the payment of an annual premium. The circuit court concluded that an annual premium excludes funds removed

from a qualified individual retirement account to pay for an individual retirement annuity: "an annual premium does not encompass funds that already were contributed to a qualified retirement plan."

Eighth Circuit Affirms Approval of Petters Settlement and Allocation of Proceeds

In *Ritchie Capital Management, L.L.C. v. Kelley*, No. 14-2482 (8th Cir. May 4, 2015), the Eighth Circuit affirmed decisions of the district court and bankruptcy court approving the allocation of proceeds derived from a settlement agreement in Petters-related litigation.

The trustee, who also serves as the receiver over Petters and related entities, entered into a settlement with a party who had received pre-petition payments from the debtor and a payment from Petters. The settlement, which was pre-approved by the creditors' committee, provided for the party to pay a lump sum to the trustee in exchange for a release of all claims by the bankruptcy estate and the receivership. The settlement was contingent on approval by both the district court overseeing the receivership and the bankruptcy court.

The settlement agreement included no provision allocating the settlement proceeds, and it contained an integration clause. When presenting the settlement to the courts, the trustee expressed an intention to allocate 15 percent of the proceeds to the receivership (which equaled the percentage of Petters's payment in relation to the overall amount received). The creditor's committee supported the settlement and the trustee's allocation.

Richie objected to the settlement allocation on various grounds, asserting it was unreasonable, gratuitous, evidenced a conflict of interest by the trustee Kelley in serving as both trustee and receiver, unsupported by the facts. The bankruptcy court overruled Richie's objection, and the district court affirmed. Richie appealed.

The Eighth Circuit further affirmed, ruling that the settlement allocation, although not explicit in the settlement agreement, became part of the agreement through the court approval process. The circuit court also reasoned that it had already considered the trustee's dual roles and rejected allegations of conflict. It also recognized that the lower courts had considerable discretion in considering the settlement and determined the underlying facts and circumstances supported the courts' decisions.

BAP Determines Lessee Entitled to Proceeds from Crops He Planted on Land Subject to Voided Lease

In *Kaler v. Slominski (In re Keeley and Grabanski Land Partnership),* Nos. 14-6037 and 14-6042 (8th Cir. BAP May 14, 2015) Eighth Circuit BAP determined that upon the determination that a fraudulent transfer had occurred, the trustee was entitled to the difference between the fair market rent and the amount paid by the defendant, but also that the defendant, as a good faith transferee, was allowed a setoff for improvements he made to the leased land.

The debtor leased certain farm land to the defendant for a period of three years for 20 percent of the gross proceeds derived from the land. Shortly thereafter, the debtor filed for bankruptcy. The defendant farmed the

land for the first year of the lease and paid the trustee $314,464.55.

The trustee attempted to sell the land; however, potential buyers objected to the lease, which was below market value. Thereafter, the trustee commenced an adversary proceeding to avoid the lease on several grounds, including that it constituted a fraudulent transfer. The bankruptcy court avoided the lease as a fraudulent transfer and awarded judgment to the trustee for the difference between the rent paid and its fair market value. The bankruptcy court further found that the defendant was entitled to certain offsets for the value of real property taxes paid and certain crops the defendant planted.

Neither party challenged whether the lease was avoidable as a fraudulent transfer, but both appealed the remedies awarded. The BAP determined that "[a]warding the [t]rustee fair market rent for the period up until termination did, in fact, put the estate back into the position it would have been had the transfer not occurred," and it therefore affirmed the bankruptcy court's ruling that the difference between what was paid and fair market rent was due from the defendant.

The BAP next turned to defendant's offset. It found that defendant was entitled "to a setoff for the lesser of" (A) the cost, to defendant, of any improvements made after the transfer and (B) any increase in the value of such property as the result of such improvement." The BAP found there was no evidence of any increase in the value of the property resulting from the improvements but that defendant was entitled to compensation for his efforts in planting crops on the land. As a result, the BAP ruled that "if [defendant] is charged rent for the time he planted and cultivated the crop, he is entitled to the proceeds from the crop. This result, once again, makes the estate whole, but prevents the estate from reaping a windfall at [defendant's] expense."

BAP Rules that an Alleged Injury Is Not Moot if a Remedy Remains Available

In *Seifert v. Carlson (In Re Seifert),* No. 14-6044 (8th Cir. BAP May 22, 2015) the Eighth Circuit BAP determined that although the parties had stipulated to resolve certain objections concerning the debtor's plan, the ultimate issue of resolving a disputed exemption claim was expressly left open for later determination, and, accordingly the creditor and trustee's objection to the debtor's claimed exemption was not moot.

The debtor filed a petition under Chapter 12 of the Bankruptcy Code. Included as an asset on the petition was $134,661 of the debtor's "farm earnings," which consisted of five checks made jointly payable to various parties, including the debtor and the creditor. The debtor claimed a $91,258 exemption as to this asset. The creditor and the trustee objected to the claimed exemption and the debtor's proposed plan, alleging, among other things, that because the claimed exemption should not be allowed, the proposed plan could not be confirmed.

The parties ultimately resolved the plan objection issue via a stipulation providing that the debtor would surrender no less than $32,500 to the trustee for costs of administration and distribution to creditors. The stipulation also provided that if the exemption was ultimately disallowed, the debtor would pay $95,000 plus interest.

Thereafter, the creditor filed a pleading asserting the exemption dispute was moot because the finds had been turned over to another creditor and, consequently, the debtor retained no interest in the funds. The bankruptcy court agreed. The debtor appealed.

The BAP reversed and remanded, recognizing that although "it is well-settled that jurisdiction of the federal courts is confined to actual controversies in which one of the litigants has a 'legally cognizable interest,'" and that developments in a case preclude a court from providing a remedy, the issue is moot, it determined that "[t]here is no doubt that the parties' stipulation, incorporated into the proposed plan, reserved the issue of the disputed claim of exemption for later determination." While the parties reached a stipulation allowing for a plan to be entered, they did not resolve the underlying issue, which remained open and thus was not moot.

BAP Determines Debt Must Exist to Give Rise to Non-Dischargeability Action

In *Wilson v. Walker, et al. (In re Walker),* No. 14-6032 (8th Cir. BAP April 7, 2015) the Court held that an unconscionable contract was not enforceable, and, therefore the debtor did not owe a debt to the creditor so there was no basis for the creditor's non-dischargeability action.

The debtor was a musician who entered into a series of management contracts with the creditor. The creditor filed an adversary proceeding pursuant to Section 523 of the Bankruptcy Code seeking to exempt from discharge a debt he claimed he was owed stemming from the contracts. The bankruptcy court determined there was no debt as the contracts were unconscionable, thus there was nothing to discharge. The creditor appealed.

The Eighth Circuit BAP affirmed, reasoning that the contracts were unconscionable under Virginia law (as called for by the contracts) because: (1) The 20-year term with four two year extension options exercisable by the creditor were excessive and out of line with industry norms, (2) The contracts contained overly burdensome procedures to terminate them, (3) the creditor's exorbitantly high compensation for the services provided, which would potentially leave the debtor with nothing after covering costs and the creditor's fees, and (4) The creditor's ability to name a replacement if the debtor could not fulfill his duties. Because the contracts were found to be unconscionable, they could not be enforced and thus there was no debt to discharge.

The BAP also affirmed the denial of the creditor's objection to the debtor's discharge, determining that because there was no debt, the creditor had no standing to object to the discharge as Section 727(c) of the Bankruptcy Code provides that "[t]he trustee, a creditor, or the United States Trustee may object to the granting of a discharge under subsection (a) of this section." Because the creditor did not fit into any of those categories, he could not object to the discharge. Further noted was that even if the creditor had standing to object to discharge, he failed to establish grounds for denial pursuant to Section 727(a).

U.S. Supreme Court Rules No Fees Charged to Estate for Successfully Defending a Fee Application

In re Baker Botts LLP v. Asarco LLC, 135 S.Ct. 2158, -- U.S. -- (decided June 15, 2015) (6-3 decision), the U.S. Supreme Court held that attorneys are not allowed to charge the estate for the fees they incur related to successfully defending a fee application.

After prevailing on a $7-$10 billion fraudulent transfer action, law firm Baker Botts was awarded fees of $113 million plus an enhancement of $4 million. After the debtor's parent company objected to the fees, Baker Botts successfully defended the fee application. Baker Botts then filed a second fee application for $5 million allegedly incurred in defending both fee applications, which the bankruptcy court granted. The district court affirmed, but the Fifth Circuit reversed and held, as a matter of law, that bankruptcy courts lack discretion to award fees for defending fee applications.

Justice Thomas wrote the decision for the majority, which held that "[b]ecause [11 U.S.C.] § 330(a)(1) does not explicitly override the American Rule with respect to fee-defense litigation, it does not permit bankruptcy courts to award compensation for such litigation." The Supreme Court further held that defense of a fee application does not constitute a compensable "service" performed for the debtor or the estate because "reasonable compensation for services rendered necessarily implies loyal and disinterested service in the interest of a client.".

Justice Breyer wrote the dissent, which would allow fees for successfully defending a fee application because Section 330(a)(1)(A) of the Bankruptcy Code allows for "reasonable compensation" and he would assert that the cost of fee litigation dilutes compensation. The dissent further asserts that fee litigation should be considered a compensable "service" because Section 330(a)(1) requires an opportunity for a hearing.

Denial of Chapter 13 Plan Confirmation Is Not an Appealable Final Order

In *Bullard v. Blue Hills Bank*, 135 S.Ct. 1686, -- U.S. --, (decided May 4, 2015) (unanimous), the U.S. Supreme Court held that an order denying confirmation of a Chapter 13 bankruptcy plan is not an appealable final order.

The debtor proposed a "hybrid" plan seeking to both cure arrears on a mortgage under 11 U.S.C. § 1322(b)(5) and also modify the balance of the mortgage down to the current appraised value under 11 U.S.C. § 1322(b)(2). The bankruptcy court denied confirmation.

The debtor appealed to the First Circuit BAP. The BAP concluded that the order denying confirmation was not final and appealable as of right under 28 U.S.C. § 158(a)(1) because the debtor merely needed to propose an alternate plan. However, the BAP granted leave to appeal under 28 U.S.C. § 158(a)(3) as an interlocutory appeal.

The debtor appealed to the First Circuit Court of Appeals, which also concluded that the order denying confirmation was not final and appealable as of right. The First Circuit declined to grant leave for an interlocutory appeal.

Chief Justice Roberts wrote the decision for a unanimous court. The court held that

denial of plan confirmation is not a final appealable order because: (1) "only plan confirmation—or case dismissal—alters the status quo and fixes the rights and obligations of the parties," (2) the "knowledge that [the debtor] will have no guaranteed appeal from a denial should encourage the debtor to work with creditors and the trustee to develop a confirmable plan as promptly as possible," and (3) debtors can petition for interlocutory appeal when a case involves a question of law that is important and divides bankruptcy courts in different districts.

BAP Finds That Hearing Not Required on Motion to Reopen Pursuant to 11 U.S.C. § 350(b)

In *Bowman v. Cassamatta* (*In re Bowman*), No. 14-6034 (8th Cir. BAP March 18, 2015) the Eighth Circuit BAP affirmed the bankruptcy court's denial without a hearing of a motion to reopen a Chapter 11 case that had been dismissed for cause.

The debtors filed a Chapter 11 case in November of 1999. Though the debtors proposed multiple plans over more than five years, none were confirmed. The case was dismissed on the motion of the US trustee, which the debtors did not appeal and the case closed in May 2005.

Nine and a half years later, in September of 2014, the debtors moved to reopen the case pursuant to 11 U.S.C. § 350(b). The US trustee and one creditor objected to the motion. The Court denied the motion without a hearing.

The debtors appealed on numerous grounds. First, they argued that Fed. R. Bankr. P. 9014(a) as well as certain local rules required a hearing on their motion. The debtors also contended that they were erroneously not permitted to file a response to the motion objections. Further, the debtors argued that the Court applied an improper legal standard by referencing Fed. R. Civ. P. 60 in its text order.

The BAP affirmed, holding the bankruptcy court not abuse its discretion in denying the motion to reopen. The BAP reasoned that neither § 350(b) nor the bankruptcy rules make reference to a hearing requirement. Additionally, because the reopening of a case is governed by Bankruptcy Rule 5010, the hearing requirement triggered by the "not otherwise governed by these rules" language of Rule 9014(a) was inapplicable. The BAP also noted that even if a hearing was required under 9014(a), such a hearing would only be afforded to the party against whom relief was sought, not the moving parties. Finally, the BAP found that in any event a failure to hold a hearing would be harmless error, regardless of whether 9014(a) or Local 5010-1 applied.

Regarding the debtors' argument concerning an opportunity to respond to the motion objections, the BAP indicated the debtors failed to demonstrate that they tried to file a response or that permission to do so was required, and further failed to present any evidence that the bankruptcy court would have rejected it.

With regard to the invocation of Rule 60 by the bankruptcy court in its text order, the BAP interpreted that portion of the order as merely pointing out the debtors' failure to offer any grounds for vacating the dismissal, indicating that reopening the case would be futile.

BAP Rules That Party with Actual Knowledge Could Not Avoid Effect of Missing Deadline to Challenge Dischargeability of Debts

In *Goldstein v. Diamond* (*In re Diamond*) No. 15-6002 (8th Cir. BAP May 11, 2015), the debtor filed a petition for relief pursuant to Chapter 7 of the Bankruptcy Code on November 29, 2011. Appellant obtained actual knowledge of the petition 22 days before the dischargeability deadline was set to expire on February 28, 2012. Although appellant filed a proof of claim and a motion requesting a 60-day "extension of proceedings" and "withholding of the entry of the discharge order," he failed to timely file an adversary complaint to determine dischargeability.

The bankruptcy court interpreted the motion as one for "abatement of the case" for 60 days, and, finding no cause for such relief, it denied the motion and the request to withhold the discharge. The discharge was granted on February 29, 2012, and the case was closed on March 15, 2012.

On March 14, 2013, appellant filed a two-count dischargeability complaint against the debtor in another federal court in a different district. The complaint made assertions of fraud and defalcation but did not refer to any particular statute. After a hearing on an order to show cause, that court where the complaint was filed transferred the adversary proceeding to the court where the underlying petition was filed.

On instructions of a bankruptcy judge, the matter was not docketed. Instead, the court issued an order instructing appellant to file a motion to reopen the underlying bankruptcy case and pay the fee. Appellant appealed.

The Eighth Circuit BAP reversed and determined there was not requirement that a bankruptcy case be reopened in order to file a dischargeability complaint. Subsequently, the bankruptcy court ordered the clerk to docket the complaint and included an order to show cause why the complaint should not be dismissed.

The appellant filed a verified response to the order to show cause. The bankruptcy court then scheduled a trial for October 1, 2014. On September 2, 2014, the debtor filed an answer including a request for dismissal. Appellant again filed a verified response to the debtor's request. The bankruptcy court struck the trial and dismissed the complaint. Appellant again appealed to the BAP.

Before reaching its ruling, the BAP first found that appellant himself was not a creditor. All of the allegations in the complaint related to debts owed by the debtor to various other entities. As such, the BAP determined that Appellant lacked standing to appeal. Further, as a pro se party without a license to practice law, appellant was prohibited from pursuing claims on behalf of the entities.

As to the appealed issue, the BAP held that to the extent the "fraud and defalcation" claims fall within the scope of 11 U.S.C. § 523(a)(4), such allegations had to have been timely raised prior to the dischargeability deadline. As they were not, dismissal was appropriate.

BAP Rules That Bankruptcy Petition Does Not Sever a Debtor's Joint Tenancy in Property

In *In re Peet*, No. 14-6033 (8th Cir. BAP April 22, 2015) the Eighth Circuit BAP

affirmed the bankruptcy court's determination to overrule the debtors' objection to the trustee's sale of property.

At the time of the filing of their petition for relief pursuant to Chapter 13 of the Bankruptcy Code, the debtors owned real estate and a titled vehicle with the debtors' parents as joint tenants. Approximately two years later, the case converted to one under Chapter 7 pursuant to the debtor's motion. The debtors' parents passed away a few months after the conversion. Thereafter, the trustee proposed to sell the real estate and vehicle. The debtors objected, arguing the filing of their bankruptcy petition severed the joint tenancy which then converted to tenancies in common, the effect of which would limit the trustee's recovery to half the proceeds derived from the sale. The bankruptcy court overruled the debtor's objection and the debtors timely appealed.

The BAP affirmed, holding that nothing in the Bankruptcy Code supports the severing of a joint tenancy upon the filing of a petition. As a result, the sale were authorized and the trustee was entitled to the proceeds from the sales of the real property and vehicle, less any portion exempted by the debtors.

Supreme Court Rules That Post-Petition Wages Retained by Chapter 13 Trustee Should Be Returned to Debtor after Chapter 7 Conversion

In *Harris v. Viegelahn*, 575 U.S. __ (decided May 18, 2015), the U.S. Supreme Court ruled that upon conversion to Chapter 7, post-petition wages retained by a Chapter 13 trustee must be returned to the debtor as they are not property of the Chapter 7 estate.

The debtor filed a petition for relief pursuant to Chapter 13 of the Bankruptcy Code. As part of the debtor's Chapter 13 plan, a portion of the debtor's wages were collected by the trustee to pay the debtor's mortgage arrears. When the debtor fell behind on her mortgage payments, the mortgagee foreclosed. The trustee continued collecting a portion of the debtor's wages, which accumulated in the trustee's account.

Approximately a year after the foreclosure, the debtor converted the case to one under Chapter 7. By that time, the Chapter 13 trustee held $5,519.22 of the debtor's post-petition wages, which the chapter 13 trustee paid to the debtor's creditors 10 days later. The debtor brought a motion seeking a refund of the accumulated post-petition wages.

The bankruptcy court granted the debtor's motion, which the district court affirmed. The circuit court reversed, holding that a Chapter 13 trustee must distribute a debtor's accumulated post-petition wages to creditors. The debtor sought review.

The U.S. Supreme Court reversed, holding that in the absence of bad faith Section 348(f) of the Bankruptcy Code limits a converted Chapter 7 estate to property belonging to the debtor as of the date of the filing of the original Chapter 13 petition. Because post-petition wages do not fit that bill, undistributed wages collected by a Chapter 13 trustee do not become property of the estate and they are excluded from the pool of assets to be liquidated and distributed to creditors. The Supreme Court also reasoned that Section 348(e) of the Bankruptcy Code terminates the service of the Chapter 13 trustee upon conversion. Therefore, upon conversion, the Chapter 13

trustee is prohibited from disbursing payments to creditors.

In Bad Faith Conversion, Chapter 13 Trustee Debtors' Post-Petition, Pre-Conversion Inheritance Is Property of Chapter 7 Estate

In the case *In re Lien*, No. 11-60636 (Bankr. D. Minn. March 16, 2015) the court held the debtors' conversion from Chapter 13 to Chapter 7 occurred in bad faith, and, therefore, the debtors were ordered to turn over certain post-petition but pre-conversation assets, including inherited monies.

Section 348(f)(2) of the Bankruptcy Code provides that if a case converts from Chapter 13 in bad faith, the property of the Chapter 7 estate consists of the debtor's property as of the conversion date, not the initial filing date. Although the Bankruptcy Code fails to define good or bad faith, case law provides for a framework of factors to review in consideration of the totality of the circumstances, which factors include, among other things, whether the motivation for the conversion was inability to make Chapter 13 plan payments, there was a disadvantage to creditors, and whether the debtor is forthcoming with regard to reporting income and assets.

After considering all of the circumstances, the court held that the debtors' conversation was in bad faith. In so ruling, the court reasoned that the debtors received a considerable inheritance which they failed to report and that the debtors did not convincingly testify that they failed to appreciate their obligation to report additional disposable income. The court also focused on the debtors' testimony that they could have continued making payments under the chapter 13 plan without incurring a financial hardship.

Accordingly, the debtors' Chapter 7 estate included the inheritance and other miscellaneous property that the debtors acquired post-petition but pre-conversion.

Turnover of Professional Compensation Not Required Simply as a Consequence of Administratively Insolvent Estate

In the case *In re Premier Healthcare Services, Inc., et. al* (Bankr. D. Minn. March 17, 2015), debtor initially filed a petition for relief pursuant to Chapter 11 of the bankruptcy code. The arrangement between the debtor and its counsel, which was approved by the court and not objected to by the US trustee, allowed the debtor to pay counsel's invoices on a monthly basis, subject to certain holdbacks and court approval.

Counsel filed an application for interim compensation in which it requested approval of modest pre-petition fees and expenses and an additional larger portion of post-petition fees to be paid from the debtor's pre-petition retained. The US Trustee did not object and the court approved the application.

Meanwhile, the state health department moved to terminate the debtor's participation in certain state health care programs and to withhold program payments to the debtor. As a consequence, the debtor could not fund its operations. Thereafter, US Trustee brought a motion to either dismiss or convert to Chapter 7 and a creditor bright a motion for relief from the automatic stay. In response, the debtor stipulated to convert to Chapter 7.

Months later, counsel filed an application for final compensation for services rendered before and after the conversion. The US trustee objected, although not to the allowance of the fees and costs sought; instead, the US Trustee objected to how counsel applied the payments previously paid by the debtor to counsel on a monthly basis.

The US Trustee argued that because counsel's request for compensation had not yet received court approval, the payments remained property of the estate and should be turned over to the Chapter 7 trustee for pro rata distribution. The US Trustee contended that authorizing counsel to retain the payments would allow it to receive an amount in excess of the pro rata distribution of is claim since the case was "very likely" administratively insolvent.

The court disagreed, noting that bankruptcy courts have wide discretion in ordering the return of excess compensation for various reasons. Noticeably absent from those reasons, however, was an express Bankruptcy Code provision granting the court authority to disgorge or order the turnover of compensation when an estate becomes administratively insolvent.

Although the court recognized that several other courts have held that implicit authority exists under the priority scheme set forth in Section 726 of the Bankruptcy Code to order the turnover of compensation when the estate becomes administratively insolvent. After noting a split of authority on the issue (including with the District of Minnesota), it held that Section 726 does not provide a basis, either express or implied, to order the turnover of professional compensation when the estate becomes administratively insolvent.

The court's ruling was based in part on its factual distinction of an earlier Minnesota case, *In re Brick Hearth Pizza, Inc.*, 302 B.R. 877 (Bankr. D. Minn. 2003). In distinguishing *In re Brick Hearth*, the court noted that the payments at issue in that case involved a pre-petition retainer. In the case at bar, the payments were post-petition payments made during the Chapter 11 administrative period and in accordance with an order allowing the debtor's to pay a portion of counsel's fees prior to court approval.

Debtors' Unilateral Notice of Removal Is Inappropriate Mechanism by which to Withdraw the Reference

In the matter of *In re Le* (Bankr. D. Minn. March 20, 2015), the court rejected the debtors' attempt to remove a pending relief from stay motion filed by a creditor from bankruptcy court to district court, presumable to delay certain foreclosure proceedings.

A day before a scheduled hearing on the creditor's motion, the debtors (acting *pro se*) presented a document that purporting to be a notice of removal to the bankruptcy court clerk. The authority cited was 28 U.S.C. § 1452, which involves authority to remove a matter originally filed in state court or another federal district court.

Initially, the bankruptcy court acknowledged that § 1452 does on apply between two federal court units of the same district that may each exercise the original jurisdiction in bankruptcy granted by § 1334(a)-(b). Put differently, a party to a bankruptcy court

proceeding could not itself invoke removal to push that proceeding from the bankruptcy judge presiding over it to a district court judge in that same district.

Instead, only a district court judge could bring about such a transfer of judicial administration within the district of initial jurisdiction and venue, said the court, and that is done only pursuant to a party's request by motion to the district court judge to withdraw the reference pursuant to § 157(b).

Because the debtors did not use that procedure, the court held that neither the clerk of bankruptcy court, nor the judge presiding over the case, had any obligation to honor the debtors' unilateral and unfounded procedural ploy to delay the hearing on the creditor's motion.

Eighth Circuit: Pre-Petition Grant of Security Interest Was Avoidable Based on Evidence of Debtor's Fraudulent Intent

In *Ritchie Capital Mgmt., LLC v. Stoebner*, 779 F.3d 857 (8th Cir. March 10, 2015), one of many cases concerning Tom Petters's multi-billion dollar fraud, the Eighth Circuit determined that the circumstances resulting in the grant of a security interest in the debtor's property in exchange for forbearance on defaulted loans of its parent company evidenced a fraudulent transfer.

In 2007 and 2008, Ritchie made several loans to the debtor's parent totaling $127 million. Some loan proceeds were used to pay obligations of the debtor. By September 2008, the debtor's parent was in default. In exchange for Richie's forbearance from enforcement, Tom Petters, acting as the parent's sole board member, granted Ritchie a security interest in several of the debtor's trademarks.

Five days later, Petters's home and offices were raided by the FBI. Thereafter, Ritchie accelerated the loans and the debtor and its parent filed separate petitions for relief pursuant to Chapter 11 of the Bankruptcy Code.

The debtor commenced an action against Ritchie, arguing the security agreement was unenforceable because it resulted from an actual fraudulent transfer under both federal and Minnesota law. The debtor's bankruptcy was eventually converted to Chapter 7 and the trustee was substituted as a party.

The trustee moved for partial summary judgment, which the bankruptcy court granted. Richie appealed and the district court affirmed. Ritchie then appealed to the Eighth Circuit.

The Eighth Circuit further affirmed, holding the transfers could be avoided. The circuit court's determination, which hinged on an examination of the "badges of fraud", focused on four of the badges to determine Petters's fraudulent intent in connection with the security interest grants. First, the Eighth Circuit determined the transfer lacked reasonably equivalent value because the parent transferred the debtor's assets when the parent was the borrower on the loan. Thus, Richie's forbearance was not sufficient value for the debtor notwithstanding that some loan proceeds were used to satisfy the debtor's financial obligations.

Also, the court determined the transfer was for the benefit of an insider, namely Tom Petters, which only served to delay the collapse of Petters's Ponzi scheme.

Next, the court examined the debtor's unmanageable indebtedness at the time of the transfer and determined it evidenced intent of fraud.

Finally, the court noted that Petters granted the security interest over the objection of the debtor's CEO, who expressed concern of thwarting the debtor's efforts to raise capital. Petters's actions, the court said, also evidenced fraudulent intent.