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IN THIS ISSUE

"Date of Transfer" When Preference Action Targets Property Held In Custodia Legis *4*

Eighth Circuit Affirmed Dismissal of Complaint by Creditor in Petters Ponzi Scheme *4*

District Court Addresses Scope of Adverse Inference Sanctions, Expert Testimony, and Bifurcation *5*

Bankruptcy Court Denies Debtor's Motion for Contempt *7*

District Court Dismisses Appeal of Orders for Failure to Object to Underlying Motions, Statutory Mootness, and Lack of Jurisdiction *7*

BAP Affirmed Denial of Request for Appointment of New Counsel, Objections to Proofs of Claims, and Motion for Writ of Mandamus *8*

Bankruptcy Court Held Fee Agreement Providing Attorney's Lien on Exempt Personal Property to Secure Post-Petition Payments Was False and Misleading *9*

Discharge Revoked for Fraud, Failing to Disclose Assets and Business Interests, Concealing and Transferring and Failing to Report Property of the Estate *10*

Eighth Circuit Holds Creditor Cannot Hide Behind Inaccurate Proof of Claim to Evade Service *11*

Debtor Barred From Refiling For 180 Days From Order *12*

Bankruptcy Court Dismissed Section 523(a)(2)(A) Claim Alleging Statement Relating to Debtor's Financial Condition *13*

District Court Held Section 303(i) of the Bankruptcy Code Preempted Tort Claims for Wrongful Commencement of Involuntary Bankruptcy *13*

Bankruptcy Court Authorized Rejection of Franchise Agreements *14*

Chapter 13 Debtor Lacked Standing to Pursue Personal Injury Claims for His Own Benefit *14*

Eighth Circuit Affirmed Chapter 11 Plan Preserved Contractual Indemnity Claims *15*

District Court Holds Transfers Were Part of Integrated Transaction for Safe Harbor Exception Under Section 546(e) *16*

Section 523(a)(2)(A)'s Passive Voice Prevents Discharge for Passive Beneficiaries of Fraud *17*

No Third-Party Stay Where Indemnification Not Certain *18*

Bankruptcy Court Removed DIP and Expanded Role of Subchapter V Trustee *19*

Bankruptcy Court Enforced Non-Compete Provisions Notwithstanding the Debtor's Rejection of the Franchise Agreements Under Section 365 .... *19*

Bankruptcy Court Applied Collateral Estoppel to Except Claim from Discharge Pursuant to Section 523(a)(6) for Willful and Malicious Injury *20*

Eighth Circuit BAP Holds Chapter 12 Plan Modification After Confirmation Under Section 1229(a) Requires a Substantial Change in Circumstances *22*

BAP Holds Post-petition, Pre-conversion Market Appreciation and an Increase in Equity Resulting from Payments Toward the Mortgage Lien Inure to the Estate's Benefit upon Conversion from a Chapter 13 to Chapter 7 .... *23*

BAP Held It Lacked Article III Jurisdiction to Impose Automatic Stay in Bankruptcy Case Dismissed While Pending Decision in the Appeal *24*

Eighth Circuit Holds Creditor Waived Right to Challenge Receiver's Final Accounting *24*

Supreme Court Holds the Bankruptcy Code Abrogates Sovereign Immunity of All Governments Including Federally Recognized Indian Tribes Under 11 U.S.C. § 101(27) and § 106(a) *25*

Judge Tanabe's Procedural Guidance on Stipulations, Dismissals, and Student Loan Discharge *26*

SCOTUS Held United States Secretary of Education Lacked Statutory Authority to Cancel $430 Billion in Federal Student Loan Debt *27*

Eighth Circuit Affirmed Bankruptcy Court's Factual Finding for Base Rate for Cramdown Under 11 U.S.C. § 1225(a)(5)(B)(ii) Based on Treasury Rate, Not Prime Rate *28*

Eighth Circuit Held Copyright Claims Were Previously Litigated in Bankruptcy Court Proceedings for Sale and Completion of Building *28*

“Date of Transfer” When Preference Action Targets Property Held In Custodia Legis

In *Ahlgren v. Miller (In re Holbert)*, 643 B.R. 332 (Bankr. D. Minn. 2022), the bankruptcy court held that for purposes of a preference action, a transfer occurs on the date funds are deposited with a court and not, as the trustee argued, on the date the court distributes the funds to the preference defendant. Because this was outside the 90-day preference window, the complaint was dismissed.

Years before seeking bankruptcy protection, the debtor entered into an agreement to own certain real property jointly with the preference defendant. Seven years later, the defendant commenced a lawsuit against the debtor in county court related to the debtor's actions regarding the real estate. The debtor filed counterclaims. After the debtor and the defendant requested partition of the property to resolve the dispute, the county court directed the property be sold at public auction, the net sale proceeds to be deposited with the county court, and for the net proceeds to ultimately be split between the debtor and the defendant per their respective shares in the property. Eventually, the defendant's share was deposited into her lawyer's IOLTA account. Almost three months later the debtor filed for Chapter 7 bankruptcy protection. The Trustee filed a complaint seeking to recover the transfer to the defendant as a preference.

The defendant moved to dismiss the adversary proceeding, arguing that the transfer in question occurred before the 90-day preference period. The defendant argued that the transfer occurred no later than the time the net proceeds were deposited with the county court, following the logic set forth in *Matter of Newcomb*, 744 F.2d 621 (8th. Cir. 1984). The Trustee argued *Newcomb* applies only in cases where an escrow is established to secure payment of a debt, not when deposited in *custodia legis* to maintain the status quo. Instead, the Trustee argued that the transfer occurred when the funds were distributed to the defendant's lawyer's IOLTA account.

The bankruptcy court first noted that the net proceeds from the sale of the property were held by the county court *in custodia legis* (in the custody of law). While no 8th Circuit law exists on the topic, other courts have held that when property is held *in custodia legis* a transfer under 11 U.S.C. § 547(b) occurs when the property is first deposited with the court. Next, the court considered whether it could analogize the facts of the case to 8th Circuit case law regarding property held in escrow, found it could, and therefore that *Newcomb*, a case considering determination of a transfer when an escrow is involved, applied. Applying *Newcomb*, the bankruptcy court concluded the relevant transfer occurred when the net proceeds were deposited with the county court, that the date of that deposit was outside the 90-day preference period, and therefore, the adversary proceeding was dismissed.

Eighth Circuit Affirmed Dismissal of Complaint by Creditor in Petters Ponzi Scheme

In *Ritchie Special Credit Investments, Ltd. v. JPMorgan Chase & Co.*, 48 F.4th 896 (8th Cir. Sept. 13, 2022), the Eighth Circuit affirmed the dismissal of the complaint based on lack of standing and failure to state a plausible claim against a creditor and consulting firm in the Petters Ponzi scheme.

Plaintiff Ritchie Special Credit Investments, Ltd. ("Ritchie") made investments that were lost in the Petters Ponzi scheme. The trustees in the Petters bankruptcy reached a settlement

for Defendant JP Morgan Chase & Co. ("JP Morgan") to repay some of what it collected during the waning days of the Petters fraud. The settlement included bar orders that prohibited creditors from asserting certain claims that belonged to the bankruptcy trustees.

Despite the bar orders, Ritchie brought the present action on the principal theory that the defendants aided and abetted the fraud by Petters; or in the alternative, the transfers to JP Morgan were fraudulent. The district court dismissed the complaint.

In the appeal, the Eighth Circuit held that Ritchie lacked standing to assert claims against JP Morgan because the causes of action belong to the bankruptcy trustees to assert. In its decision, the Eighth Circuit noted that the debtor could have asserted the claims against JP Morgan before the bankruptcy. As such, the claims belonged to the bankruptcy trustees based on the general bankruptcy-standing doctrine and the bar orders.

The Eighth Circuit also affirmed the dismissal of the aiding and abetting claim against Defendant Richter Consulting, Inc. ("Richter") for failure to state a plausible claim. Richie's complaint alleged that Richter misled through due-diligence documents. Nevertheless, the Eighth Circuit noted that Ritchie's complaint failed to allege enough facts for the element of aiding and abetting under New York law that Richter had "actual knowledge" that Petters himself was engaged in fraud. Rather, the Eighth Circuit found there was no more than constructive knowledge of inflated accounts-receivable figures, sham loans, and financial trouble for the legitimate company Polaroid Corporation.

The Eighth Circuit affirmed the judgment of the district court.

District Court Addresses Scope of Adverse Inference Sanctions, Expert Testimony, and Bifurcation

In *Kelley v. BMO Harris Bank N.A.*, 2022 WL 4547022, the district court addressed the scope of adverse inference spoliation sanctions that were previously imposed; motions to exclude expert testimony; and a motion to bifurcate punitive damages from liability and compensatory damages.

The plaintiff, the chapter 11 trustee for the bankruptcy proceeding concerning Petters Company, Inc. ("PCI") and the defendant, BMO Harris Bank N.A. ("BMO Harris"), each filed motions for clarification on the scope of the adverse inference. Both parties also filed motions to exclude the others banking and damages experts. BMO Harris also filed a motion to bifurcate the punitive damages portion of the trial from the liability and compensatory damages portion of the trial.

The district court first addressed the scope of the adverse inference spoliation sanctions. The parties disagreed as to whether the adverse inference sanction was rebuttable. The district court held that since there was not an identified "particular document of crucial evidentiary value" that was destroyed, a permissive adverse inference subject to reasonable rebuttal was the appropriate sanction. The district court reasoned that allowing the sanctioning party to put on some evidence that might demonstrate an innocent explanation for the conduct would avoid unfair prejudice. For the same reason, the court held that the adverse inference jury instruction will not be provided until after the evidentiary phase of the trial concludes.

The district court then addressed each parties' expert testimony. Both parties moved to exclude testimony from each other's experts on banking and damages. The district court first addressed BMO Harris' banking expert, finding that the expert had improperly opined about the mental state of what M&I Marshall

and Ilsley Bank ("M&I") (predecessor to BMO Harris) and its employees knew or did not know. BMO Harris' banking expert also improperly speculated about the knowledge and mental state of third parties to, in turn, improperly speculate that M&I and its employees likely had the same knowledge and mental states. The district court disagreed with the trustee's argument about the expert lacking sufficient factual basis and the expert's testimony undermining the adverse inference sanction. Therefore, the district court granted in part the trustee's motion to exclude BMO Harris' banking expert's testimony as it pertained to speculation about the knowledge and state-of-mind of others.

Next, the district court addressed BMO Harris' damage expert finding that the expert had improperly opined about the knowledge and culpability of PCI's investors; offsets, deductions, and recoveries; and alternative damage theories. The district court found that the expert's testimony was not relevant to BMO Harris' liability, was inconsistent with the collateral source rule, and relied on a "flawed legal theory" regarding offsets. The district court did not find the damages expert testimony pertaining to state-of-mind, causation, and undermining the adverse inference sanction to be improper and, accordingly, granted the trustee's motion in part and denied it in part.

The district court then turned to the trustee's experts. The district court found that the trustee's banking expert had improperly testified to the state-of-mind of others – where the expert had testified to the "willful blindness" of M&I and its employees or what they knew. Second, the district court also held that the trustee's banking expert had improperly testified about the Bank Secrecy Act, stating that their opinions about whether M&I had violated the Bank Secrecy Act have "little or no apparent relevance," and the risk of unfair prejudice outweighed the probative value of such opinions. The district court did not find that the trustee's banking expert had improperly summarized evidence or was unqualified to testify about deposit account control agreements, as BMO Harris had argued. Hence, the district court granted BMO Harris' motion to exclude the trustee's banking expert in part and denied it in part.

The district court continued on to address the trustee's damages expert. BMO Harris argued that the trustee's damages expert's testimony should be excluded because it was contrary to established law and the methodology the expert had relied on was unreliable and improperly applied. The district court held that BMO Harris failed to show that the damages expert's testimony was improper and denied the motion to exclude the testimony.

The district court then turned to the BMO Harris' motion to bifurcate the punitive damages portion of the trial from the liability and compensatory damages portion of the trial. BMO Harris argued that Minnesota state law mandates bifurcation but the district court found that state law was inapplicable. The district court stated that even when applying state substantive law, federal courts apply federal law as to matters of procedure. The district court then looked at Federal Rules of Civil Procedure 42 to resolve the issue.

Rule 42 provides that "[f]or convenience, to avoid prejudice, or to expedite and economize, the court may order a separate trial of one or more separate issues." Fed. R. Civ. P. 42(b). The district court noted that BMO Harris did not contend, and the district court could not conclude, that bifurcating would "promote convenience or otherwise expedite or economize the case." BMO Harris did contend that bifurcation was necessary to avoid prejudice. BMO Harris argued that evidence of its financial condition, net worth, or income might influence the jury when assessing its liability or the amount of compensatory damages.

The district court pointed out that BMO Harris did not provide any evidence or persuasive argument to support its "broad, speculative generalization" about the risk of prejudice. "It is unlikely that jurors will be surprised to learn the financial condition, net worth or income of a large bank in a case such as this one." Further, the court noted, the jury will be instructed as to the appropriate application of the law and the jury is presumed to follow the instructions. Accordingly, the district court denied BMO Harris' motion to bifurcate.

Bankruptcy Court Denies Debtor's Motion for Contempt

In *In re Paczkowski*, 2022 WL 5264705 (Bankr. D. Minn. Oct. 6, 2022), the U.S. Bankruptcy Court for the District of Minnesota (the "Court") denied a chapter 7 debtor's motion for contempt against certain creditors because the creditors' actions did not violate the Court's order. Previously, the Court issued an order granting the creditors' motion for relief from the automatic stay to pursue and liquidate certain Minnesota Uniform Voidable Transactions Act ("MUVTA") claims against the debtor in state court, but not to collect on any resulting judgment without the Court's permission. Subsequently, the creditors obtained a state court monetary judgment for the MUVTA claims, and thereafter, motioned for prejudgment interest and attorneys' fees.
The debtor then filed the contempt motion with the Court, alleging that the creditors should be held in contempt for violating the Court's order by obtaining a state court monetary judgment and seeking an award for attorney's fees. The debtor further alleged that the creditors engaged in prohibited collection activity by docketing a judgment.

The Court denied the debtor's motion under the civil contempt standard in *Koehler v. Grant*, 213 B.R. 570 (B.A.P. 8th Cir. 1997), under which the movant must prove by clear and convincing evidence that the respondent (1) had knowledge of an order and (2) violated such order, determining that the Court's order explicitly authorized litigation of the state court MUVTA claims and that the creditors did not engage in prohibited collection activity because the creditors did not file an affidavit of identification of the debtor as required under Minn. Stat. § 548.09, subd. 2 to docket a judgment.

District Court Dismisses Appeal of Orders for Failure to Object to Underlying Motions, Statutory Mootness, and Lack of Jurisdiction

In *Green v. Nosek*, 2022 WL 16857106 (Nov. 10, 2022), the U.S. District Court for the District of Minnesota dismissed an appeal of orders granting motions to sell real property and of orders denying a motion for reinstatement of the debtor as the possessor of those properties and for a related evidentiary hearing.

The debtor owned 15 residential rental properties. The debtor filed a chapter 11 bankruptcy petition in July 2021, and a subchapter V trustee was appointed. After the United States Trustee moved to remove the debtor from possession of the properties pursuant to 11 U.S.C. § 1185 and for the appointment of a trustee to assume the debtor's duties, the subchapter V trustee was appointed to assume the debtor's duties.

The sole shareholder of the debtor filed a motion for reinstatement or, in the alternative, for dismissal of the bankruptcy. The motion was denied. The shareholder then filed a second motion for reinstatement or, in the alternative, for dismissal (the "Second Reinstatement Motion"). The shareholder also filed a related motion requesting an evidentiary hearing (the "Evidentiary Hearing Motion"). The Second Reinstatement Motion and the Evidentiary Hearing Motion were both denied.

The subchapter V trustee assumed possession of the properties and began efforts to sell the properties. The subchapter V trustee entered

into purchase agreements and filed motions to sell the assets free and clear of liens, claims, and encumbrances. When two of those motions (the "Motions to Sell") were filed in March 2022, the shareholder did not file objections or appear at the related hearing. The court entered orders granting the Motions to Sell.

The shareholder filed an appeal of the orders granting the Motions to Sell and the orders denying the Second Reinstatement Motion and the Evidentiary Hearing Motion. He requested that the appeal be heard by the district court. Creditor Wilmington Trust N.A., which held liens on all 15 residential rental properties, moved to dismiss the shareholder's appeal.

The district court first considered the appeal of the orders granting the Motions to Sell. Wilmington Trust argued that the shareholder had waived his right to appeal these orders when he failed to object to the underlying motions when they were before the bankruptcy court. The shareholder responded that he had objected to the relief in his appeals of prior orders granting motions to sell other properties. The district court found that though the shareholder had objected to two earlier motions to sell, he did not object to the Motions to Sell underlying the specific orders currently on appeal to the district court. Accordingly, the district court held that the shareholder had forfeited his right to appeal those specific orders.

The district court also held that the appeal of the orders granting the Motions to Sell was statutorily moot because the sales had been consummated. The shareholder had requested a stay of the sales pending his appeal, but that request had been denied. In addition, the shareholder had not alleged that the purchasers of the properties were not acting in good faith. Therefore, the district court held that the requirements for statutory mootness under 11 U.S.C. § 363(m) were met.

The district court next considered the shareholder's appeal of the orders denying the Second Reinstatement Motion and the Evidentiary Hearing Motion. Wilmington Trust argued that the district court lacked jurisdiction over the appeal of those orders because the orders were not final orders. The district court agreed and found that both orders were interlocutory orders. Because the district court only has jurisdiction to hear appeals from interlocutory orders with leave of the court and because the shareholder had not sought leave to appeal those orders, the district court held that it lacked jurisdiction to hear the appeal.

Having held that the shareholder had forfeited his right to appeal the orders granting the Motions to Sell, that the appeal of the orders granting the Motion to Sell was statutorily moot, and that the district court did not have jurisdiction to hear the appeal of the orders denying the Second Reinstatement Motion and the Evidentiary Hearing Motion, the district court granted Wilmington Trust's motion to dismiss and dismissed the appeal.

BAP Affirmed Denial of Request for Appointment of New Counsel, Objections to Proofs of Claims, and Motion for Writ of Mandamus

In *In re Reichel*, 645 B.R. 620 (B.A.P. 8th Cir. 2022), the Eighth Circuit BAP affirmed the denial of the debtor's requests for appointment of counsel, writ of mandamus, summary judgment, and recusal.

The debtor filed a petition for Chapter 7 relief and signed a stipulation that waived his bankruptcy discharge. In 2016, a jury in a criminal case determined that the debtor engaged in wire fraud and bankruptcy fraud by illegally transferring funds from investors and employees to himself, and the court sentenced the debtor to prison. In 2017, the Chapter 7 trustee was discharged from service when the bankruptcy case was closed. Thereafter, the

debtor filed a host of motions to reopen the bankruptcy case that were denied by the bankruptcy court and affirmed on appeal. For the present appeal, the debtor objected to a bankruptcy court order disposing of matters.

For the appeal, the debtor argued that his twenty-seven motions were inappropriately blanket denied by the bankruptcy court. The BAP disagreed and found that the bankruptcy court sufficiently addressed the motions, including the rejection of the debtor's argument that his legal counsel had a conflict of interest as both his legal representative and staff attorney for the Chapter 13 trustee.

The debtor also argued the trustee failed to properly examine proofs of claims in the bankruptcy case. In rejecting the argument, the BAP found the debtor missed opportunities to object to several proofs of claim during the pendency of the case. Further, the BAP indicated proofs of claim that do not substantially comply with the documentation requirements for Federal Rule of Bankruptcy Procedure 3001 are allowed, unless the debtor establishes an exception to the allowance of the claim under 11 U.S.C. § 502(b). In the record, certain attorneys for creditors that filed proofs of claim alleged in pleadings and at the objection hearing that debtor's counsel was given supporting documentation. Thus, the BAP concluded the bankruptcy court did not abuse discretion in denying the motions objecting to proofs of claims.

The debtor further argued he paid taxes as a "penalty fee" forced on him by the trustee. The BAP found the assertion disingenuous at best because the payment was part of a settlement of the debtor's tax refunds, and the debtor raised the issue nearly ten years after the settlement and without supporting evidence. Likewise, the BAP rejected another mischaracterization by the debtor that the trustee "forced" a payment in exchange for personal property seized in a court-approved inspection.

The BAP concluded that the bankruptcy court did not abuse its discretion, and the debtor failed to demonstrate cause to reopen the bankruptcy case.

Bankruptcy Court Held Fee Agreement Providing Attorney's Lien on Exempt Personal Property to Secure Post-Petition Payments Was False and Misleading

In *In re Turner*, 2022 WL 17408088, Judge Tanabe issued another decision taking aim at consumer debtor attorneys' efforts to provide post-petition payment plans to debtors. The fee agreement at issue stated that the debtor's attorney would take an attorney's lien under Minnesota Statutes § 481.13 against some of the debtor's personal property to secure payment of the $1,647 flat fee. Because the attorney believed the flat fee was secured by a lien on the personal property, which would survive a bankruptcy discharge, the attorney gave the debtor an option to pay the flat fee over time, including after the commencement of the case.

Interpreting Minnesota's exemption statutes, the Court determined that an attorney's lien cannot attach to personal property that is exempt under Minnesota law. The Court further stated that the personal property described as collateral in the fee agreement was exempt property under Minnesota law. As a result, the Court found that the attorney's fee agreement included false and misleading statements about the existence and effect of an attorney's lien in the debtor's personal property. This violated the requirement of 11 U.S.C. § 526(a)(2) that bankruptcy attorneys not make untrue or misleading statements to consumer debtors. The Court then applied § 526(c)(1) to hold that the fee agreement was void and could not be enforced by the attorney.

Discharge Revoked for Fraud, Failing to Disclose Assets and Business Interests, Concealing and Transferring and Failing to Report Property of the Estate

In *In re Bebeau*, 2022 WL 17661134 (Bankr. D. Minn. Dec. 12, 2022) the court revoked the chapter 7 debtor's discharge at the request of the U.S. Trustee for fraud, false statements and material omissions, and concealing and transferring property of the estate with fraudulent intent.

Jason Bebeau, the debtor, had interests in multiple business entities that were involved in construction and property development. Through those businesses, Bebeau worked with his friend and "finance guy" on various projects. Bebeau's friend would provide funding for those projects, without documentation, and to Bebeau personally.

Just before filing bankruptcy, Bebeau met with his friend and his fiancé and orchestrated several transfers of his assets to his fiancé in a deliberate effort to conceal business interests and assets from the court. No consideration was received by Bebeau in exchange for the transfers to his fiancé. A backdated transfer document was used, which appeared to legitimize the transfer by incorrectly stating it was in resolution of one entity's claims against the other (though there was never any such indebtedness).

Bebeau continued to purchase properties and engage in development projects through the use of those undisclosed business entities. He continued to use the business accounts for his ongoing, daily personal expenses, transferring large amounts but not disclosing any of the transfers. And at the same time, maintaining he was unemployed and his interest in the businesses was "worth zero." He then created another business account to assist in the transfer of funds because, as Bebeau told another business partner, he "needed it not to be traceable." Immediately after discharge was entered, his fiancé transferred the previously transferred business interests back to Bebeau.

Bebeau's Discharge Revoked as it was Obtained through Fraud

Discharge may be revoked under 11 U.S.C. § 727(d)(1) if it was obtained through Bebeau's fraud and the U.S. Trustee did not have knowledge of the fraud until after discharge was granted.

The court first looked to 11 U.S.C. § 727(a)(4)(A) to determine whether Bebeau knowingly and fraudulently made a false oath, and considered:

(1) ***Whether Bebeau made a statement under oath?*** Bebeau was required to verify his bankruptcy filings under penalty of perjury, and his signature has the force and effect of an oath.

(2) ***Whether the statement was false?*** Bebeau failed to disclose certain business interests, his employment with one of those entities, his pre- and post-petition (personal) use of the business account, and significantly misstated (undervalued) the assets of at least one of those entities.

(3) ***Whether Bebeau knew the statement was false?*** Bebeau continued to work on development projects and had full access to the bank accounts of various business entities. His use of those undisclosed accounts and business interests throughout the case evidenced his awareness that his statements and omissions were false.

(4) ***Whether Bebeau made the statement with fraudulent intent?*** Statements made with reckless indifference to the truth are regarded as intentionally false.

(5) ***Whether the statement related materially to the bankruptcy case?*** The

false statement must be "material" in order to support denial of discharge. However, the threshold to materiality is "fairly low" and established when it bears any relationship to the bankruptcy estate, discovery of assets, business dealings or the existence or disposition of the debtor's property. Here, the undisclosed assets belonged to the bankruptcy estate.

The court also looked to 11 U.S.C. § 727(a)(2), which allows a discharge to be denied if the debtor, within a year prior to the bankruptcy filing, transfers, destroys or conceals property of the estate with the intent to hinder, delay, or defraud. A presumption of fraud arises when a debtor transfers valuable property without consideration, and the twelve badges of fraud can then be used to determine if a debtor acted with the requisite intent. It is not necessary to prove fraudulent intent – a finding that the debtor had actual intent to hinder or delay creditors is sufficient.

Weighing the credibility of witnesses and applying the badges of fraud – most notably that Bebeau made the transfer to his fiancé just prior to filing bankruptcy for no consideration while retaining possession and control – the court found that Bebeau concealed and transferred property with the express intent to keep assets out of his bankruptcy case.

Bebeau's Discharge Revoked for Knowingly and Fraudulently Failing to Report Post-Petition Property of the Estate

Revocation of discharge is also allowed under 11 U.S.C. § 727(d)(2) when a debtor knowingly and fraudulently failed to disclose, deliver, or surrender an acquisition or interest in property of the bankruptcy estate. The ongoing duty of disclosure requires a debtor to promptly update schedules upon becoming aware of any inaccuracies or omissions. Bebeau did not do so.

Bebeau received regular checks of thousands of dollars, routinely moved money through various accounts to make transfers "not traceable," purchased multiple properties during bankruptcy and had significant access to cash. Bebeau did not disclose any of this.

Therefore, the court held that the U.S. Trustee established sufficient grounds to revoke Bebeau's discharge and did so under 11 U.S.C. §§ 727(d)(1) and 727(d)(2).

Eighth Circuit Holds Creditor Cannot Hide Behind Inaccurate Proof of Claim to Evade Service

In *PIRS Capital, LLC, v. Williams*, 54 F.4th 1050 (8th Cir. 2022), the Eighth Circuit Court of Appeals applied Federal Rule of Bankruptcy Procedure 7004 to hold the bankruptcy trustee properly effected service of an adversary complaint.

The appellant filed a proof of claim in a bankruptcy case, and about two years later, the bankruptcy trustee filed an adversary complaint naming the appellant as defendant. The bankruptcy trustee served the complaint to the appellant to the attention of the individual who signed the appellant's proof of claim as "managing partner" and at the address the proof of claim identified as the address where notices should be sent. To confirm the individual identified as managing partner on the proof of claim was the appropriate agent, the bankruptcy trustee reviewed New York Department of State records which revealed that, though appellant had no registered agent, the "Selected Entity Address Information" listed the address to which the Department of State would mail process as the "managing partner" at the address the bankruptcy trustee served. Unbeknownst to the bankruptcy trustee, the appellant was no longer at that office (having moved six months earlier), and the individual identified as the "managing partner" on the proof of claim no longer worked for the appellant. Despite the incorrect

address, the complaint was still delivered to the appellant, and one of appellant's employees signed the return receipt, despite not being authorized to receive service.

After no response by the appellant, the bankruptcy trustee moved for default judgment and a notice of hearing on that motion was again sent to the incorrect address upon which the bankruptcy trustee served the complaint. The bankruptcy court granted the trustee's motion and entered default judgment against the appellant.

Almost three years later, the bankruptcy court entered an order granting the bankruptcy trustee's objection to the appellant's proof of claim. That order was sent to appellant at both the incorrect address upon which the trustee served the complaint *and* the correct address. The appellant then moved the court to vacate the default judgment granted in the adversary proceeding, arguing first that the judgment was void under Federal Rule of Civil Procedure 60(b)(4) because the complaint was served on the wrong person and address for Federal Rule of Bankruptcy Procedure 7004(b)(3), and second that the service error denied appellant the full and fair opportunity to litigate its defenses, justifying relief under Federal Rule of Civil Procedure 60(b)(6). The bankruptcy court denied the appellant's motion, concluding that (1) the bankruptcy trustee properly effected service by relying on information appellant provided in its proof of claim and by researching the Department of State website, and (2) appellant's failure to respond to the complaint and motion for default judgment was due to its own errors including designating the "managing partner," failing to update bankruptcy court and Department of State records, and failing to ensure mail would be forwarded to the appellant's new address. The district court affirmed for the same reasons.

In reviewing the district court's affirmance, the Eighth Circuit held that appellant ignored controlling Supreme Court caselaw defining when a judgment is void for purposes of Fed. R. Civ. P. 60(b)(4). The case *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 270-71 (2010), held that relief under Rule 60(b)(4) based on a jurisdictional defect is reserved for exceptional cases where the court rendering judgment lacked an arguable basis for jurisdiction. The Eighth Circuit reasoned the bankruptcy court *did* hold at least an arguable basis for jurisdiction because (1) the bankruptcy trustee served appellant in the manner consistent with appellant's filed proof of claim, which was reinforced by the bankruptcy trustee's independent research, (2) the trustee sent the summons and complaint by certified mail, return receipt requested, and received the receipt showing the summons and complaint was actually received by a PIRS employee at its new (and correct) location, and (3) an entity served by legal process should not benefit from its own inaccurate or dated records when others attempt in good faith to determine the appropriate agent for service.

The Eighth Circuit declined to entertain the appellant's Rule 60(b)(6) argument because that rule is only available when Rules 60(b)(1) through (b)(5) are inapplicable, and the circumstances leading to the appellant's failure to defend were of its own making and did not amount to "exceptional circumstances" justifying relief.

The Eighth Circuit affirmed the district court's order.

PIRS reminds parties to keep information in proofs of claim accurate and up-to-date, and evidence of actual receipt for service of process can trump noncompliance with rules of procedure.

Debtor Barred From Refiling For 180 Days From Order

In *In re Atkinson*, 2022 WL 17722840 (Bankr. D. Minn. Dec. 15, 2022), the bankruptcy court held the debtor was ineligible for relief for a

180-day period after the voluntary dismissal of an earlier case that followed a motion for relief from stay.

The debtor filed a petition for bankruptcy relief under Chapter 13 (the "Prior Case"). In July 2022, the bankruptcy court granted a mortgage creditor's motion for relief from the automatic stay in the Prior Case. Thereafter, the debtor filed an application to voluntarily dismiss the Prior Case, which was granted on October 18, 2022. A mortgage foreclosure sale was scheduled for October 25, 2022. On the day before the sale, the debtor filed another bankruptcy case (the "Present Case"), in an apparent attempt to thwart the sale.

The Chapter 13 trustee moved the court to dismiss the Present Case pursuant to 11 U.S.C. § 109(g) which makes ineligible for relief an individual who previously had filed a bankruptcy petition within the prior 180 days, and in the earlier case "the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by [11 U.S.C. § 362]." In ruling on the motion to dismiss, the bankruptcy court interpreted this statutory language as mandatory and barred the debtor from refiling for 180 days from the date of the order (not from the date of filing of the petition in the Present Case). The bankruptcy court annulled the automatic stay and dismissed the Present Case.

Bankruptcy Court Dismissed Section 523(a)(2)(A) Claim Alleging Statement Relating to Debtor's Financial Condition

In *In re Rankin (Liberty Bail Bond Agency v. Rankin)*, 2022 WL 17742293 (Bankr. D. Minn. Dec. 16, 2022), the bankruptcy court granted debtor/defendant's motion to dismiss the claim for a debt to be nondischargeable under 11 U.S.C. § 523(a)(2)(A).

In its complaint, the plaintiff alleged that it relied upon debtor's knowingly false statement she could repay a bail bond in monthly installments of $150.

For the present motion to dismiss, the bankruptcy court determined the plaintiff only sought relief under § 523(a)(2)(A), which makes clear it only applies to "false pretenses, a false representation, or actual fraud, *other than a statement respecting the debtor's . . . financial condition.*" § 523(a)(2)(A) (emphasis added). A statement respecting the debtor's financial condition has "a direct relation to or impact on the debtor's overall financial status." *Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 1752, 1761 (2018). In other words, if the allegedly false statements relate to the debtor's financial status, then a creditor must pursue relief under § 523(a)(2)(B). *See In re Ophaug*, 827 F.2d 340, 342-43 (8th Cir. 1987) (explaining the two subsections of § 523(a)(2) are mutually exclusive).

For the present motion, the bankruptcy court concluded that the statement the plaintiff allegedly relied upon was respecting the debtor's financial condition. Thus, the bankruptcy court held § 523(a)(2) was inapplicable.

The bankruptcy court granted the motion to dismiss and ordered the adversary proceeding dismissed with prejudice.

District Court Held Section 303(i) of the Bankruptcy Code Preempted Tort Claims for Wrongful Commencement of Involuntary Bankruptcy

In *Stursberg v. Morrison Sund*, 648 F. Supp. 3d 1075 (D. Minn. 2023), the district court granted the defendants' motions to dismiss because the amended complaint was not authorized, and 11 U.S.C. § 303(i) preempted the plaintiff's state common-law tort claims for wrongful commencement of an involuntary bankruptcy case.

The defendant law firm represented the plaintiff in another action but withdrew based on unpaid legal fees. Thereafter, the defendant law firm filed an involuntary chapter 7 bankruptcy petition against the plaintiff. The bankruptcy court ordered the dismissal of the involuntary petition based on abstention under 11 U.S.C. § 305(a)(1) and later denied the plaintiff's motion for attorney fees. The plaintiff sued the defendants in the Eastern District of Pennsylvania in the present case, and the present case was transferred to the District of Minnesota. After transfer, the defendant law firm renewed its motion to dismiss and the plaintiff filed an amended complaint.

For the motion, the district court held the plaintiff missed his chance to amend his complaint as a matter of right under Federal Rule of Civil Procedure 15(a)(1) within 21 days after service of the defendant's motion to dismiss under Federal Rule of Civil Procedure 12(b), and the exhaustion of this right remained after the case was transferred. Further, the district court held the plaintiff's claims in the case were not precluded because the bankruptcy court's agreed-to abstention and dismissal of the involuntary bankruptcy petition under § 305 was not on the merits. The bankruptcy court also denied the plaintiff's motion for attorney fees because it would be inconsistent to decline jurisdiction based on the best interests of the parties but yet award attorney fees.

The district court granted the motion to dismiss, and the case was dismissed with prejudice.

Bankruptcy Court Authorized Rejection of Franchise Agreements

In *In re EllDan Corp.*, 2023 WL 175195 (Bankr. D. Minn. Jan. 12, 2023), the bankruptcy court granted the debtor's motion to reject its franchise agreements pursuant to 11 U.S.C. § 365.

The debtor maintained it exercised sound business judgment for the benefit of the estate in the determination that the costs of royalty fees due to the franchisor outweighed the benefits received under the franchise agreements. The counterparty franchisor objected to the rejection. The bankruptcy court held that the debtor's rejection decision was not manifestly unreasonable or made in bad faith. Thus, the court approved the debtor's rejection of the franchise agreements under section 365, leaving the contract counterparty with claims for breach of contract under applicable non-bankruptcy law, and not a rescission of the contract.

Further, the bankruptcy court declined to review the parties' requests for declaratory and injunctive relief regarding the non-compete provision because of the limited review for the contested matter under Federal Rule of Bankruptcy Procedure 9014. The bankruptcy court ordered the parties may commence an adversary proceeding under Federal Rule of Bankruptcy Procedure 7001 to pursue the additional relief, and the franchisor may file a motion for relief from the automatic stay under 11 U.S.C. § 365(d) to pursue any remedies under applicable non-bankruptcy law.

Chapter 13 Debtor Lacked Standing to Pursue Personal Injury Claims for His Own Benefit

In *Hughes v. Wisconsin Central Limited*, 2023 WL 1477835 (D. Minn. Feb. 2, 2023), the district court held that the chapter 13 debtor lacked standing to pursue personal injury claims solely for his own benefit.

In May 2012, the debtor filed a petition for chapter 13 relief. The debtor/plaintiff allegedly was injured on the job in railroad accidents in 2016 and 2017. He failed to disclose the personal injury claims before his chapter 13 bankruptcy discharge was granted in February 2018.

In October 2019, the plaintiff filed the pending lawsuit for personal injury claims. In August 2021, the bankruptcy court granted the plaintiff's motion to reopen the bankruptcy case, and the plaintiff amended his schedules to disclose the personal injury claims. In October 2021, the district court denied defendants' motions for summary judgment without prejudice and stayed the lawsuit pending a decision by the bankruptcy court on a motion by the plaintiff to approve a stipulation with the trustee to reopen the bankruptcy case and allow the plaintiff to schedule the lawsuit as a contingent unliquidated claim. The bankruptcy court denied the motion, and defendants refiled their present motions for summary judgment.

For the present motions, the plaintiff argued he had standing to bring the claims because the bankruptcy court held the lawsuit vested in the debtors upon the bankruptcy discharge. In holding a lack of standing, the district court noted that the bankruptcy court ruled it was too late to modify the chapter 13 plan; and therefore, it was now clear that the plaintiff was unable to pursue his claims on behalf of the estate and therefore lacked standing.

Further, the district court applied the doctrine of judicial estoppel because the bankruptcy court for the chapter 13 plan and discharge adopted the position that the personal injury claims did not exist, and it would be an unfair advantage for proceeds from the damages for the lawsuit to go directly to the plaintiff and not the creditors.

The district court granted defendants' motions for summary judgment and dismissed the lawsuit with prejudice.

Eighth Circuit Affirmed Chapter 11 Plan Preserved Contractual Indemnity Claims

In *ResCap Liquidating Trust v. Primary Residential Mortgage, Inc.*, 59 F.4th 905 (8th Cir. 2023), the United States Court of Appeals for the Eighth Circuit affirmed that the chapter 11 plan preserved indemnity claims to be pursued by a liquidating trust on behalf of certain bankruptcy claimants.

A lender sold loans to a mortgage loan sponsor ("sponsor") pursuant to agreements wherein the lender agreed to indemnify the sponsor for all losses from any representation, warranty, or obligation made by the sponsor in reliance on a misstatement or omission by the lender. After the 2008 housing market collapse, the sponsor entered into pre-bankruptcy and bankruptcy settlements with trusts, investors, and insurers for claims against the sponsor for its representations made in the securitization of the loans as residential-mortgage backed securities ("RMBS"). In the sponsor's chapter 11 case, the bankruptcy court confirmed a chapter 11 plan that expressly: (1) preserved "Causes of Action," including indemnity claims; (2) created a liquidation trust to pursue indemnification claims against the lender; and (3) exchanged claims for equity for a class of trusts and insurers ("unitholders") in the liquidating trust and for a *pro rata* distribution to the unitholders of proceeds recovered from the indemnity claims against the lender.

The liquidating trust brought indemnity claims against several defendants including the lender. In a motion to dismiss argued in 2015, several defendants maintained that the indemnity claims were expressly discharged in the chapter 11 plan; and therefore, the sponsor was released from all liabilities for the indemnity claims.

In the June 2015 decision, the district court discussed that property of the bankruptcy estate reverts to the debtor except "as otherwise provided in the plan or the order confirming the plan." 11 U.S.C. § 1141. In distinguishing cases cited by the defendants, the district court held that the chapter 11 plan preserved the contractual indemnity claims via express preservation language. Note the

Bankruptcy Code, under 11 U.S.C. § 1123(b)(3), states that the contents of a chapter 11 plan may provide for "the retention and enforcement . . . by a representative of the estate" to pursue claims of the bankruptcy estate.

The district court later reaffirmed the June 2015 decision and granted summary judgment in favor of the liquidating trust on the issue of preservation of the contractual indemnity claims in the chapter 11 plan.

On appeal, the lender argued before the Eighth Circuit that the bankruptcy court's confirmation order "extinguished" (discharged) indemnity claims; and therefore, the liquidating trust can only seek indemnity for what the sponsor actually paid in bankruptcy. In calling the argument preposterous, the Eighth Circuit concluded the chapter 11 plan transferred to the liquidating trust the contractual indemnity claims against the lender. Further, the Eighth Circuit affirmed that the lender's indemnification provisions applied to the sponsor's liabilities, not just its actual losses.

The Eighth Circuit also affirmed the district court on contractual issues, damages, and attorney's fees, but vacated a portion of the award of state statutory interest as preempted by 28 U.S.C. § 1961(a) for postjudgment interest.

District Court Holds Transfers Were Part of Integrated Transaction for Safe Harbor Exception Under Section 546(e)

In *Kelley v. Safe Harbor Managed Account 101, Ltd.*, 654 F. Supp. 3d 850 (D. Minn. 2023), the district court granted the defendant's motion for summary judgment after remand on the issue of whether transfers were in connection with the note purchase agreement for 11 U.S.C. § 546(e) of the Bankruptcy Code.

The liquidating trustee filed an action against the defendant to recover funds transferred from Arrowhead Capital Management Corp. ("Arrowhead") to the defendant. The defendant moved for summary judgment on the grounds that the transfers it received from Arrowhead were protected by § 546(e).

In relevant part here, § 546(e) provides the trustee cannot avoid a transfer made by or to a financial institution "in connection with" a securities contract.

For § 546(e), the Eighth Circuit affirmed that Arrowhead was the financial institution and the note purchase agreement was the securities contract. Further, the relevant transfers were from MGC Finance to Arrowhead. The Eighth Circuit remanded for the determination of whether the transfers from MGC Finance to Arrowhead were "in connection with" the note purchase agreement for § 546(e).

In its decision, the Eighth Circuit explained that in the context of § 546(e) a transfer is "in connection with" a securities contract if it is related to or associated with the securities contract and that there is a low bar for the required relationship between the securities contract and the transfer sought to be avoided.

On remand, the liquidating trustee argued that the transfers were not made in connection with the note purchase agreement, but rather pursuant to a separate credit agreement between MGC Finance and Metro I, LLC ("Metro"). Under the credit agreement, MGC Finance agreed to execute and deliver promissory notes to Metro. For the note purchase agreement, Metro agreed to assign the promissory notes to Arrowhead. When Arrowhead received payment from MGC Finance on the promissory notes, the funds were repaid to investors, including the defendant.

The district court held that the transfers at issue were part of an integrated transaction "in

connection with" the note purchase agreement. Thus, the district court concluded that the transfers were immune under § 546(e).

Section 523(a)(2)(A)'s Passive Voice Prevents Discharge for Passive Beneficiaries of Fraud

In *Bartenwerfer v. Buckley*, 598 U.S. 69 (2023), the United States Supreme Court held that 11 U.S.C. § 523(a)(2)(A), which bars debtors from discharging any debt obtained by fraud, applies to a debtor liable for fraud she did not personally commit. In other words, § 523(a)(2)(A)'s discharge exception for debt "obtained by . . . fraud" does not require the debtor to be the fraudster. So long as the individual debtor is found to be liable for another's fraud under state law, the debt is not dischargeable under § 523(a)(2)(A).

Kate Bartenwerfer and her then-boyfriend and business partner, David Bartenwerfer, decided to remodel a house and sell it at a profit. David took charge of the project while Kate remained largely uninvolved. When they sold the house to Kieran Buckley, the Bartenwerfers attested that they had disclosed all material facts relating to the property. Buckley subsequently discovered several undisclosed defects and sued the Bartenwerfers in California state court. The state-court jury ruled in Buckley's favor and held the Bartenwerfers jointly liable for damages.

The Bartenwerfers then filed for chapter 7 bankruptcy and Buckley filed an adversary complaint alleging that the state-court judgment was a debt obtained by fraud and therefore nondischargeable. Based on testimony, the bankruptcy court found that David knowingly concealed the defects from Buckley and his fraudulent intent could be imputed to Kate as his legal business partner. The 9th Circuit Bankruptcy Appellate Panel reversed, holding that § 523(a)(2)(A) barred Kate from discharging the debt only if she knew or had reason to know of David's fraud. The bankruptcy court, on remand, found that Kate lacked the requisite culpability under the BAP's holding and the BAP affirmed the new judgment. The 9th Circuit subsequently reversed and held that a debtor liable for her partner's fraud cannot discharge that debt in bankruptcy, regardless of culpability.

The United States Supreme Court unanimously held that Kate could not discharge the debt. Justice Barrett, writing for the Court, focused on every legal writing professor's favorite topic: passive voice. Section 523(a)(2)(A) states that an individual debtor is not discharged from a debt "to the extent obtained by—(A) false pretenses, a false representation, or actual fraud . . . ." Kate argued that the statute is most naturally read to bar discharge of debts for money obtained by *the debtor's* fraud. As an example, she offered the sentence "Jane's clerkship was obtained through hard work," which she argued is most naturally read to mean that *Jane's* hard work led to the clerkship, not just any person's hard work. Justice Barrett, in a passage destined to be quoted in the next edition of every legal writing book, writes that Kate's hypothetical sentence conveys only that *someone's* hard work led to Jane's clerkship, whether it be Jane's hard work, a recommender's hard work, or a career counselor's hard work. Section 523(a)(2)(A)'s phrasing is similarly broad: the text conveys only that *someone's* fraud led to the debt being obtained. However, Justice Barrett noted, the debtor does need to be liable in some way for the fraud and § 523(a)(2)(A) does not define the scope of that liability. For that question, state law governs; bankruptcy law takes a debt as it finds it.

In the rest of the opinion, Justice Barrett drilled down on further historical support for the Court's determination that § 523(a)(2)(A) does not require the debtor to have committed the fraud. First, the Court has previously held that passive voice signifies Congress's focus on the event that occurs, not the actor. Second, Congress's use of active language in

§§ 523(a)(2)(B) and (C) implies that Congress's use of passive language in § 523(a)(2)(A) was intentional. Third, when Congress passed the Bankruptcy Act in 1898, it removed pre-1898 language that limited the discharge exception to fraud "of the bankrupt," signifying Congress's decision to embrace pre-1898 case law that held individuals liable for the frauds committed by their partners in the scope of a partnership. Finally, Justice Barrett noted that a debtor's interest in a "fresh start" does not erase state fraud liability; if that were the case, § 523 would not exist.

In a concurring opinion, Justice Sotomayor, joined by Justice Jackson, clarified that the Court's prior holdings already incorporated into § 523 the common-law principles of fraud, which include agency and partnership principles. As a result, the Court's same conclusion could be reached by noting that the bankruptcy court found Kate and David to have an agency relationship, which makes her liable for his fraud regardless of her culpability under state law. However, Justice Sotomayor noted, the Court's holding should be read as addressing situations in which the fraudster has no agency or partnership relationship with the debtor.

No Third-Party Stay Where Indemnification Not Certain

In *Jama v. Wright County*, 2023 WL 2238803 (D. Minn. Feb. 27, 2023), Magistrate Judge Docherty declined to extend the automatic stay to a debtor's employee. In doing so, he weighed in on (1) who has authority to determine the extent of an automatic stay, (2) whether the stay extends to a third party potentially indemnified by a debtor, and (3) the distinction between an automatic bankruptcy stay and a court's discretionary stay.

The plaintiff sued multiple defendants over injuries sustained while incarcerated. One of the defendants subsequently filed for bankruptcy. *See In re MEnD Correctional Care, PLLC*, No. 22-60407 (Bankr. D. Minn.) (Ridgway, J.) (ch. 11 filed Nov. 20, 2022, converted to ch. 7 eff. Feb. 21, 2023). The plaintiff brought a motion to stay the litigation pending the debtor's bankruptcy or, in the alternative, for 90 days. While everyone agreed that the bankruptcy stay applied to the debtor, the motion centered around the effect of the stay on one of the debtor's employees and, therefore, the litigation as a whole.

Before analyzing the extent of the bankruptcy stay, Judge Docherty considered whether he even had the authority to make such a determination. Observing that the Eighth Circuit has yet to weigh in on the question, the court cited interests in comity in "declin[ing] the invitation to extend its reach into bankruptcy matters." *Jama*, 2023 WL 2238803, at *3.

Despite this, Judge Docherty went on to opine that the automatic stay likely did not extend to the employee. The court observed that the Eighth Circuit applies a strict standard, extending a bankruptcy stay to non-debtors "only if a claim against the non-debtor will have an immediate adverse economic consequence for the debtor's estate." *Id.* (ultimately quoting *Ritchie Capital Mgmt. L.L.C. v. Jeffries*, 653 F.3d 755, 762 (8th Cir. 2011)). The court then found that any requirement that the employee be indemnified by the debtor or its insurance was not certain (for example, if the employee were to be found personally liable for the alleged intentional misconduct). Judge Docherty concluded that such circumstances did not rise to an immediate adverse economic consequence for the debtor's estate.

Having decided not to apply the bankruptcy stay to non-debtor defendants, the court then distinguished between the automatic stay and the court's inherent discretionary authority to stay proceedings. Acknowledging the challenges posed by the bankruptcy stay, Judge

Docherty agreed to stay the proceedings for 90 days to account for those challenges.

This decision highlights the narrow scope of the automatic stay as to third parties in this circuit. It is hard to imagine a situation where an indemnification provision is unlimited. Accordingly, it seems unlikely that this circuit will be seen as friendly to venue-shopping mass-tort debtors looking to protect their officers and affiliates with a bankruptcy stay.

Bankruptcy Court Removed DIP and Expanded Role of Subchapter V Trustee

In *In re Duling Sons, Inc.*, 650 B.R. 578 (Bankr. D.S.D. 2023), Judge Kesha Tanabe found cause to remove the debtor as debtor-in-possession ("DIP") and to expand the role of the subchapter V trustee.

The debtor filed a voluntary petition for Chapter 11 relief and elected to proceed under Subchapter V. In the case, several motions were filed to convert from Chapter 11 to Chapter 7 pursuant to 11 U.S.C. § 1112, or alternatively, to remove the DIP pursuant to 11 U.S.C. § 1185. By the conclusion of the final hearing on the motions, the major stakeholders supported removing the DIP and expanding the role of the subchapter V trustee.

A Chapter 11 case can be converted to Chapter 7 for "cause" under § 1112(b)(4)(A) for substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation. In the case, the court found cause under § 1112(b)(4)(A) because the case had been pending for 16 months, there was a threat to the administrative solvency of the case, and the DIP had shown little progress in securing support of creditors for a plan of reorganization.

The court also noted that "cause" to convert under § 1112(b)(1) or "cause" to remove the DIP under § 1185(a) can include where the DIP has a conflict of interest in properly investigating and pursuing potential fraudulent transfers and other claims of the estate, such as where a principal of a debtor would have to sue himself or herself. In finding a non-curable conflict of interest, the court noted that the shareholder in control of the debtor appeared to have engaged in gross mismanagement of the debtor's business, likely committed fraud, and engaged in self-dealing against the debtor. As such, he would have to sue himself to fulfill his fiduciary obligations to the estate. Thus, the court found "cause" under the applicable statutes to dismiss, convert, or remove the debtor as DIP.

The court decided to remove the DIP pursuant to § 1185(a) and to expand the role of the subchapter V trustee pursuant to 11 U.S.C. § 1183(b)(2) and (5). In doing so, the court noted the general advantages of Subchapter V including cost-effectiveness, elimination of the absolute priority rule, and the impaired accepting claim requirements for the confirmation standard.

Section 1189(a) of the Bankruptcy Code provides that only the debtor can file a plan. In the case, the court ordered that the debtor has 90 days from the date of the order to file a joint plan with the subchapter V trustee, or else, the case would be converted to Chapter 7.

Bankruptcy Court Enforced Non-Compete Provisions Notwithstanding the Debtor's Rejection of the Franchise Agreements Under Section 365

In *EllDan Corporation v. Fantastic Sams Franchise Corp.* (*In re EllDan Corp.)*, 2023 WL 3394917 (Bankr. D. Minn. May 11, 2023), the bankruptcy court granted summary judgment to the franchisor in holding that the post-termination, non-compete covenants were enforceable; the plaintiffs breached the non-compete covenants by operating in the current locations; the franchisor was entitled to injunctive relief notwithstanding the debtor's

rejection of the franchise agreements under 11 U.S.C. § 365; and the franchisor's remaining claims were mooted by the parties' stipulation.

EllDan Corporation and Kevin Steele (collectively, the "plaintiffs") executed seven franchise agreements, all of which include non-compete covenants for hair care business. In its bankruptcy, the debtor rejected the franchise agreements pursuant to § 365. Nevertheless, the debtor continued to operate salons at certain locations.

The franchisor sought injunctive relief based on the following five counts: (1) breach of contract for violation of covenants not to compete; (2) violation of the Lanham Act; (3) violation of the Minnesota Deceptive Trade Practices Act; (4) common-law trademark infringement; and (5) common-law unfair competition. Further, the franchisor filed a motion for a preliminary injunction. The parties disagreed over the legal effect of the covenants not to compete in their franchise agreements. The parties consented to summary judgment to resolve the dispute.

The court held that the duration and geographic scope of the non-compete covenants in the franchise agreements for the hair care businesses were reasonable under Minnesota law. The non-compete covenants contained a durational restriction of a 2-year period after termination of the agreements, and geographical restrictions of a 5-mile radius from the original location and a 2.5-mile radius from any other franchisee.

Further, the court noted that Kevin Steele ("Steele") did not execute the non-compete covenants in his capacity as a salon employee, and the businesses were purchased for roughly $1 million. As such, the court concluded that public interest would not be harmed by enforcement of the non-compete covenants in the context because the agreements were between businesses, not an individual employee in a position of unequal bargaining power. Thus, the court determined that the non-compete covenants were reasonable and enforceable under Minnesota law.

The court held the debtor breached the non-compete covenants by currently operating in certain locations.

The court concluded that the franchisor was entitled to injunctive relief as expressly provided under the franchise agreements as a remedy. In support, the court cited its previous decision that the debtor's rejection of the franchise agreements under § 365 did not result in a rescission of the remedies under those agreements including the franchisor's right to seek injunctive relief upon a breach of those agreements by the debtor.

The court held the remaining claims were mooted by the parties' stipulation wherein the debtor consented to a permanent injunction with respect to the alleged Lanham Act violations. As such, the court noted there is no additional relief available to the franchisor with respect to its other claims.

The court ordered the plaintiffs to immediately cease to operate the hair care businesses at certain locations, and the plaintiffs were further enjoined from owning or operating a hair care business at any location in violation of the non-compete covenants until 2 years after termination of the agreements. Further, the court ordered that the injunctive relief also applied to the shareholders, members, partners, and managers of the debtor, as well as immediate family of Steele.

Bankruptcy Court Applied Collateral Estoppel to Except Claim from Discharge Pursuant to Section 523(a)(6) for Willful and Malicious Injury

In *Garven v. Paczkowski (In re Paczkowski)*, 2023 WL 3588404 (Bankr. D. Minn. May 22, 2023), the bankruptcy court excepted from discharge the claim against the debtor in the debtor's

Chapter 7 bankruptcy case pursuant to 11 U.S.C. § 523(a)(6) for willful and malicious injury.

Casey and Gina Garven (the "Garvens"), together with DRMP Concrete, LLC (collectively, the "plaintiffs") commenced an adversary proceeding to except from discharge their claim in the debtor's bankruptcy case pursuant to 11 U.S.C. § 523(a)(4) for embezzlement or larceny, as well as § 523(a)(6) for willful and malicious injury. The plaintiffs moved for summary judgment on the claim. Further, the plaintiffs sought the application of the doctrine of collateral estoppel to preclude the re-litigation of issues decided by a jury in a state court action for claims against the debtor pursuant to the Minnesota Uniform Voidable Transactions Act ("MUVTA").

As applicable here for MUVTA, "[a] transfer made or obligation incurred by a debtor is voidable as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation . . . with actual intent to hinder, delay, or defraud any creditor of the debtor." Minn. Stat. § 513.44(a)(1).

In the trial on the MUVTA claim, the jury answered questions in the affirmative that the debtor, in his capacity as the sole member of a certain limited liability company (the "company') transferred assets of the company with the intent to hinder, delay, or defraud the Garvens and the Garvens were damaged as a result. The state court adopted the jury answers in its findings of fact.

The bankruptcy court in the decision on the summary judgment motion indicated that embezzlement under § 523(a)(4) "is the fraudulent appropriation of property of another by a person to whom such property has been entrusted or into whose hand it has lawfully come." For the element that requires "property of another," the bankruptcy court noted the state court findings support the conclusion the debtor, as the sole member of the company, transferred assets he either directly or indirectly owned. As a result, the bankruptcy court concluded the transfers did not constitute embezzlement for § 523(a)(4).

For larceny under § 523(a)(4), the bankruptcy court noted the larceny exception does not apply if the initial possession of the property at issue was lawful. Because the debtor was the sole owner of the company at the time it transferred the assets, the bankruptcy court concluded the debtor's possession of the assets was lawful. Thus, the bankruptcy court concluded that the transfers did not constitute larceny for § 523(a)(4).

For willful and malicious injury under § 523(a)(6), the bankruptcy court explained the following three elements must be satisfied: "(1) the debtor caused an injury to the creditor; (2) the injury was willfully inflicted; and (3) the debtor's action was malicious."

For the injury element, the bankruptcy court noted the jury found the Garvens were damaged by the transfers, and the jury answered that the Garvens were entitled to damages as a result. Thus, the bankruptcy court concluded the injury element was satisfied.

Further, the bankruptcy court noted the jury found the debtor made the transfers with the intent to hinder, delay, or defraud. As such, the bankruptcy court concluded that the injury was willfully inflicted, and the debtor's action was malicious.

Therefore, the bankruptcy court granted the plaintiffs' motion for summary judgment for willful and malicious injury under § 523(a)(6) and excepted from discharge the plaintiffs' claim against the debtor in his bankruptcy case.

Eighth Circuit BAP Holds Chapter 12 Plan Modification After Confirmation Under Section 1229(a) Requires a Substantial Change in Circumstances

In *In re Swackhammer*, 650 B.R. 914 (B.A.P. 8th Cir. 2023), the United States Bankruptcy Appellate Panel of the Eighth Circuit ("BAP") held that Chapter 12 plan modification after confirmation under 11 U.S.C. § 1229(a) requires a showing, at a minimum, of a "substantial change in circumstances." Further, the BAP held the bankruptcy court did not abuse its discretion by confirming the debtors' fourth modified plan under § 1229, and the bankruptcy court's factual findings were not clearly erroneous.

The debtors filed a petition for Chapter 12 bankruptcy relief. On several occasions, the debtors successfully modified their Chapter 12 plan after confirmation over the objections of Farm Credit Services of America, PCA ("Farm Credit"). For the present appeal, Farm Credit requested the BAP to reverse the bankruptcy court's order confirming the debtors' fourth modified Chapter 12 plan.

Farm Credit argued that modification of a Chapter 12 plan after confirmation pursuant to § 1229 should be only permitted if the debtor can show an "unanticipated, substantial change in circumstances." Section 1229(a) provides, "At any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified . . . ." Section 1229 does not expressly state a standard to determine whether to grant the request for modification. Thus, an issue before the BAP was the standard applicable to post-confirmation plan modification under § 1229.

In its analysis on the issue, the BAP noted the language of § 1229 is nearly identical to that governing modification of Chapter 13 plans under 11 U.S.C. § 1329. As such, the BAP looked to its prior holding that modification of a confirmed Chapter 13 plan should be limited to situations in which there has been "a substantial change in circumstances." *In re Johnson*, 458 B.R. 745, 748 (B.A.P. 8th Cir. 2011). Further, the BAP pointed to a similar holding in an earlier Eighth Circuit case, *Educ. Assistance Corp. v. Zellner*, 827 F.2d 1222 (8th Cir. 1987).

Based on these previous holdings, the BAP held that plan modification under § 1229(a) requires a showing, at a minimum, of a "substantial change in circumstances."

Applying this standard, the BAP held that the debtors met their burden for plan modification under § 1229(a). In support, the BAP cited to delay in financing that caused the debtors to lose acreage they could farm on their own behalf. The BAP found the loss of acreage constituted a substantial change in circumstances.

Further, the BAP held that the bankruptcy court did not clearly error in finding the fourth modified plan was feasible and confirmable. Section 1229(b) provides, in part, that the feasibility test under 11 U.S.C. § 1225(a)(6) applies to the post-confirmation modification of a Chapter 12 plan. Section 1129(a)(6) states, in part, that the court shall confirm the plan if "the debtor will be able to make all payments under the plan and to comply with the plan."

In support of the feasibility of the fourth modified plan, the BAP cited the debtors' previous performance under prior plan modifications, the seasonality of the debtors' revenue, and social security and insurance proceeds.

The BAP held that the bankruptcy court did not abuse its discretion by confirming the debtors' fourth modified plan under § 1229, and the bankruptcy court's factual findings were not clearly erroneous. Thus, the BAP affirmed the bankruptcy court.

BAP Holds Post-petition, Pre-conversion Market Appreciation and an Increase in Equity Resulting from Payments Toward the Mortgage Lien Inure to the Estate's Benefit upon Conversion from a Chapter 13 to Chapter 7

In *Goetz v. Weber (In re Goetz)*, 651 B.R. 292 (B.A.P. 8th Cir. 2023), the United States Bankruptcy Appellate Panel for the Eighth Circuit ("BAP") affirmed the bankruptcy court's ruling, stating that the post-petition, pre-conversion equity increase of the property belonged to the bankruptcy estate and not to the debtor.

Machele L. Goetz (the "Debtor") had filed for bankruptcy relief under Chapter 13 of the Bankruptcy Code, valuing her residence at $130,000.00 and claiming a $15,000.00 homestead exemption. Freedom Mortgage held a mortgage lien of $107,460.54 against the residence. The bankruptcy court confirmed the Debtor's Chapter 13 plan, and later, the Debtor's case was converted to a Chapter 7. Pursuant to the confirmation order and 11 U.S.C. § 1327(b) of the Bankruptcy Code, property of the estate vested in the Debtor on confirmation. At the time of conversion, the value of Goetz's residence had increased to $205,000.00, and the mortgage lien had decreased to approximately $106,500.00.

After conversion, the Debtor filed a motion to compel the trustee to abandon the residence, but the bankruptcy court denied the motion. The BAP determined that the increase in equity between the petition date and the conversion date is property of the Chapter 7 bankruptcy estate, and Goetz's residence had more than "inconsequential value and benefit to the estate" under 11 U.S.C. § 554.

On appeal, Goetz raised two primary arguments. First, she claimed that the bankruptcy court erred in considering the post-petition, pre-conversion market appreciation and equity increase resulting from mortgage payments as property of the estate. Second, she argued that her residence was removed from the bankruptcy estate upon confirmation of her Chapter 13 plan or when she exempted it, and any equity accruing after these events belonged to her.

The BAP reviewed the bankruptcy court's decision for clear error in the factual findings and reviewed the conclusions of law de novo. The BAP concluded that the bankruptcy court correctly determined that the post-petition, pre-conversion increase in equity that resulted from market appreciation and mortgage payments belonged to the bankruptcy estate.

The BAP examined the relevant sections of the Bankruptcy Code, particularly 11 U.S.C. § 541, which defines property of the estate, and 11 U.S.C. § 348, which addresses property of the estate in a converted case. The BAP noted that different courts had different interpretations on whether post-petition increases in equity should benefit the debtor or the estate.

Ultimately, the BAP agreed with the bankruptcy court's reasoning that post-petition, pre-conversion equity increases are property of the estate. The BAP rejected the Debtor's argument that the legislative history supported a different outcome, stating that there was no ambiguity in the applicable sections of the Bankruptcy Code. Even if there were ambiguity, the BAP found that the legislative history did not mandate a different interpretation.

Therefore, the BAP affirmed the bankruptcy court's order denying the Debtor's motion to compel the trustee to abandon the property. The BAP concluded that the increase in equity belonged to the bankruptcy estate and not to the Debtor.

BAP Held It Lacked Article III Jurisdiction to Impose Automatic Stay in Bankruptcy Case Dismissed While Pending Decision in the Appeal

In *Davies v. Daugherty (In re Davies)*, 651 B.R. 445 (B.A.P. 8th Cir. 2023), the United States Bankruptcy Appellate Panel of the Eighth Circuit ("BAP") dismissed the appeal for lack of jurisdiction.

Timothy Michael Davies (the "Debtor") filed a voluntary petition to commence a Chapter 13 bankruptcy case. The Debtor had filed multiple bankruptcy petitions in the preceding year. As a result, the Debtor was not entitled to the benefit of the automatic stay pursuant to 11 U.S.C. § 362(c)(4)(B). The Debtor then filed a motion seeking to impose the automatic stay in his most recently filed case. The bankruptcy court denied the motion. The Debtor timely appealed to the BAP. While the appeal was pending, his bankruptcy case was dismissed.

The BAP held that dismissal of the underlying bankruptcy case caused the Debtor's appeal to be constitutionally moot. *See* U.S. Const., Art. III, § 2, cl. 1. The BAP cited to *Williams v. CitiFinancial Mortgage Co. (In re Williams)*, 256 B.R. 885, 895 (B.A.P. 8th Cir. 2001), stating that "[w]hen circumstances change while an appeal is pending that make it impossible for the court to grant 'any effectual relief whatsoever' to a prevailing party, the appeal must be dismissed as moot." Further citing to *Olive St. Inv., Inc. v. Howard Sav. Bank*, 972 F.2d 214, 216 (8th Cir. 1992), the BAP explained that dismissal of the underlying bankruptcy case rendered moot the need for an automatic stay in such case, thereby eliminating the BAP's ability to provide any effective relief to the Debtor on appeal. Upon a determination of constitutional mootness, the court no longer has subject matter jurisdiction with respect to such matter.

Thus, the BAP dismissed the appeal for lack of jurisdiction.

Eighth Circuit Holds Creditor Waived Right to Challenge Receiver's Final Accounting

In *United States v. Kelley*, 70 F.4th 482 (8th Cir. 2023), the Eighth Circuit affirmed a district court's order granting a receiver's motion to wind up a receivership, including approval of its fees, a final accounting, and record-retention policies. The Eighth Circuit held that a creditor had waived its ability to object to the receiver's motion under a prior settlement agreement. It further held that the district court did not abuse its discretion by approving the receiver's final accounting and record-retention policies.

A creditor entered into a settlement agreement with the receiver and the government in 2019. The district court approved this settlement. The settlement was accompanied by a 'bar order' that prohibited the creditor from asserting related claims in any other cases. Under the terms of the agreement, the receiver and the government agreed not to oppose the creditor's motion for stay relief. In exchange, the creditor agreed not to file any additional motions, make any additional requests, or take any other action against the receiver or in the receivership's case. The Eighth Circuit held that objecting to the receiver's final accounting was an action against the receivership and was thus barred by the 2019 settlement agreement.

On appeal, the creditor argued that the district court abused its discretion by approving record-retention policies that allow the receiver to charge parties for access to certain records. The creditor also argued that the final accounting was particularly deficient for not identifying each entity in the receivership. The Eighth Circuit rejected both claims, stating that the creditor failed to identify any legal support for such positions, thus ruling that the district court had not abused its discretion by approving the receiver's motion.

Supreme Court Holds the Bankruptcy Code Abrogates Sovereign Immunity of All Governments Including Federally Recognized Indian Tribes Under 11 U.S.C. § 101(27) and § 106(a)

In *Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin,* 599 U.S. 382 (2023), the United States Supreme Court held that the Bankruptcy Code ("Code") unambiguously abrogates the sovereign immunity of all governments, including federally recognized Indian tribes. The Supreme Court reaffirms that Congress does not need to use any particular words to make its abrogation intent clear in addition to the First Circuit's conclusion that the Bankruptcy Code "unequivocally stripes tribes of their immunity." *In re Coughlin*, 33 F.4th 600, 603 (1st Cir. 2022).

Lac Du Flambeau Band of Lake Superior Chippewa Indians (the "Band") is a federally recognized tribe that lent Brian Coughlin $1,100 as a high-interest short-term loan under one of the Band's business entities, Lendgreen. Coughlin filed for Chapter 13 bankruptcy before fully repaying the loan, triggering an automatic stay against collection efforts by creditors including Lendgreen. Lendgreen, however, continued its efforts to collect despite being reminded of the pending bankruptcy petition. Coughlin filed a motion in Bankruptcy Court, seeking to enforce the stay against Lendgreen and damages for emotional distress, along with costs and attorney's fees.

The Band moved to dismiss Coughlin's complaint arguing that the Bankruptcy Court lacked subject-matter jurisdiction over Coughlin's enforcement proceedings, as the Band and its subsidiaries enjoyed tribal sovereign immunity from suit. 11 U.S.C. § 101(27) defines "governmental unit" for the purpose of the Code while 11 U.S.C. § 106(a) abrogates the sovereign immunity of "governmental unit[s]." The Band attempted to sow doubt into the ambiguity of the statutory provisions by arguing that the catchall phrase "other foreign or domestic government" does not apply to Indian tribes as they are not purely foreign or domestic and that Congress has historically treated various types of government differently for purposes of bankruptcy law.

In its analysis on the issue, the Supreme Court notes that the language in § 101(27) for the definition of "governmental unit" to be "all-encompassing" in scope and that such catchall phrase used by Congress express all-inclusiveness in addition to the pairing of the two extremes. The Court provides "[t]he pairing of 'foreign' with 'domestic'" as a piece of those other common expressions as car manufacturers would be inclusive of any and all manufacturers that comes to mind under the phrase "foreign or domestic." Alongside the Court's analysis of Congress' repeated characterization of tribes as governments, the Court finds that tribes are indisputably governments and § 106(a) unmistakably abrogates their sovereign immunity. The Supreme Court also notes that the Code's purpose was meant to facilitate an "orderly and centralized" debt-resolution process in their analysis.

The Supreme Court denies the Band's two arguments that the statutory provisions can be plausible read in a way that preserves their immunity. The Court explains that Congress has expressly instructed that the word "or" as used in the Code, "is not exclusive," rejecting the Band's argument that the catchall phrase was meant to capture entities created through "interstate compacts." The Court further explains that if such argument was applied as law, then the distinguishing between the definition of government would become skeptical. The Court also rejects the Band's argument that their immunity exists because of Congress' historical differential treatment of various types of governments on the basis that Congress has clearly altered their views on treating various types of governments

differently. "Both § 101(27)'s definition of 'governmental unit' and § 106(a)'s abrogation of sovereign immunity were some of the changes Congress made."

The Supreme Court held that the First Circuit applied the law correctly by affirming that the Bankruptcy Code unequivocally abrogates the sovereign immunity of Indian tribes.

Judge Tanabe's Procedural Guidance on Stipulations, Dismissals, and Student Loan Discharge

In *Stewart v. U.S. Department of Education (In re Stewart),* 2023 WL 4276909 (Bankr. D. Minn. June 29, 2023), Judge Kesha Tanabe used two adversary parties' procedural blunder as an opportunity to issue written guidance on settlements, undue hardship, and voluntary dismissal.

Maureen Leah Stewart ("Stewart" or the "Debtor") and the U.S. Department of Education jointly filed a document captioned "Stipulation for Discharge of Plaintiff's United States Department of Education Loans and to Dismiss Adversary Proceeding with Prejudice" (the "Stipulation") along with a proposed order (the "Proposed Order"). (Dkt. No. 13). The Stipulation purported to stipulate that Stewart's student loans were dischargeable as an "undue hardship" under 11 U.S.C. § 523(a)(8) and that the parties jointly wished to dismiss the adversary proceeding with prejudice. The Proposed Order, if entered, would have approved the "undue hardship" determination and dismissed the case. Although the parties likely had good intentions, the Stipulation could not be approved and the Proposed Order could not be entered. To start, the court could not enter the Proposed Order without a motion requesting entry of that order. Fed. R. Civ. P. 7(b)(1)(B) (made applicable by Fed. R. Bankr. P. 7007). But, more importantly, the Stipulation conflated distinct procedures under the Federal Rules of Bankruptcy Procedure. Rather than deny the parties implicit request for relief in an oral ruling, Judge Tanabe used the opportunity to present written guidance for the parties' counsel and for the bankruptcy bar more broadly.

Without substantively addressing the content of the Stipulation and Proposed Order, Judge Tanabe explained each avenue that could have been taken "to the extent the parties [were] seeking" various outcomes. First, to the extent the parties were seeking an order approving the terms of the Stipulation, they needed to file a motion pursuant to Fed. R. Bankr. P. 9019. Second, to the extent the parties were seeking a judicial determination that the Debtor satisfied the criteria for discharge due to "undue hardship" under 11 U.S.C. § 523(a)(8), they needed to file a stipulation of facts and an accompanying motion for summary judgment pursuant to Fed. R. Bankr. P. 7056. Finally, to the extent the parties were seeking to stipulate to voluntary dismissal of the adversary proceeding, they did not need to file—and, in fact, should not have filed—the Proposed Order. Since the U.S. Department of Education had not yet filed an answer, Stewart was entitled to dismiss the adversary proceeding without a court order under Fed. R. Civ. P. 41(a) (made applicable by Fed. R. Bankr. P. 7041). If the Stipulation was indeed a Rule 41(a) stipulation, entry of the Proposed Order would constitute an abuse of discretion by the court since a Rule 41(a) stipulation dismisses an action upon its filing and deprives the court of authority to enter further orders.

Overall, Judge Tanabe noted, the Federal Rules of Bankruptcy Procedure do not provide a mechanism whereby parties may direct the court to adopt the parties' determination that a debt satisfies the criteria for "undue hardship" discharge using a Rule 41(a) stipulation. The parties could, however, consent to entry of a judgment stating that the debt is dischargeable as "undue hardship" although the consent judgment would not be a judicial determination of "undue hardship" under § 523(a)(8). Rather,

it would be a judicial determination of the parties' consent to deem the debts dischargeable. To the extent that was the parties' intention—and it probably was—Judge Tanabe directed them to revise the Stipulation and submit a consent judgment in lieu of the Proposed Order.

Judge Tanabe's order has since been picked up by both Lexis and Westlaw, expanding its reach and relevance. In light of the U.S. Supreme Court's decision in *Biden v. Nebraska*, 143 S. Ct. 2355 (2023), student loan hardship discharge will continue to play a role in consumer bankruptcy cases and *Stewart v. U.S. Department of Education* will prove to be a useful cite. Practitioners representing consumer debtors and government agencies would be wise to use Judge Tanabe's guidance to avoid turning a consensual agreement into a procedural mess.

SCOTUS Held United States Secretary of Education Lacked Statutory Authority to Cancel $430 Billion in Federal Student Loan Debt

In *Biden v. Nebraska*, 143 S. Ct. 2355 (2023), the United States Supreme Court held that the United States Secretary of Education ("Secretary") lacked authority under the Higher Education Relief Opportunities for Students Act of 2003 ("HEROES Act") to depart from the existing provisions of title IV of the Higher Education Act of 1965 ("Education Act") and establish a student loan forgiveness program that would eliminate the federal student loan debt of most borrowers.

The Education Act authorizes the Secretary to assist in making available the benefits of postsecondary education through federal student loans. 20 U.S.C. § 1070(a). Under the HEROES Act, the Secretary "may waive or modify any statutory or regulatory provision applicable to the student financial assistance programs under title IV of the [Education Act] as the Secretary deems necessary in connection with a war or other military operation or national emergency." § 1098bb(a)(1). Additionally, the Secretary may issue such waivers or modifications only "as may be necessary to ensure" that "recipients of student financial assistance under title IV of the [Education Act affected by a national emergency] are not placed in a worse position financially in relation to that financial assistance because of [the national emergency]." §§ 1098bb(a)(2)(A), 1098ee(2)(C)–(D).

During the COVID-19 pandemic in 2022, the Secretary invoked the HEROES Act to issue waivers and modifications that reduced or eliminated the federal student debt of most borrowers (roughly $430 billion in debt). Six States, including Missouri, challenged the plan as exceeding the statutory authority of the Secretary. The Supreme Court granted certiorari to address whether the Secretary had authority under the HEROES Act to depart from the existing provisions of the Education Act and establish the student loan forgiveness program.

Before the Supreme Court, the Secretary argued the States lacked Article III standing to challenge the Secretary's program. In rejecting the argument, the Supreme Court held that at least Missouri had standing because the program would cost a government instrumentality of Missouri an estimated $44 million annually in fees.

Further, the Supreme Court held that the text of the HEROES Act does not allow the Secretary to rewrite the statute to cancel the $430 billion of student loan principal under the loan forgiveness plan. The Supreme Court concluded that the plan was not a waiver or modification under the statute because the plan augmented and expanded existing provisions dramatically and was effectively the introduction of a whole new regime.

Eighth Circuit Affirmed Bankruptcy Court's Factual Finding for Base Rate for Cramdown Under 11 U.S.C. § 1225(a)(5)(B)(ii) Based on Treasury Rate, Not Prime Rate

In *Topp v. Farm Credit Services of America (In re Topp)*, 75 F.4th 959 (8th Cir. 2023), the United States Circuit Court for the Eighth Circuit ("Eighth Circuit") affirmed the factual finding for the discount rate for cramdown pursuant to 11 U.S.C. § 1225(a)(5)(B)(ii) with a starting point of the treasury rate, not the prime rate.

The farmer filed a petition for Chapter 12 bankruptcy relief. The lender filed a $595,000 secured claim arising from five loans of various durations from ten to twenty years, with interest rates ranging from 3.5% to 7.6%. Together, the loans were secured by $1.45 million of the farmer's real estate. As such, the lender's claim was over-secured.

The lender objected to the farmer's Chapter 12 plan of reorganization pursuant to § 1225(a)(5)(B)(ii). For such a cramdown, the plan must promise future property distributions whose total value "as of the effective date of the plan" are not less than the allowed amount of the secured claim.

While both parties agreed to a twenty-year repayment period, the parties disagreed on the appropriate discount interest rate for determining the present value of future payments for § 1225(a)(5)(B)(ii). The farmer proposed starting with the twenty-year treasury bond rate (1.87% at the relevant time) and adding a 2% risk adjustment. The lender argued for the national prime rate (3.25% at the time) but otherwise agreed with a 2% risk adjustment. Thus, the parties disagreed on the proper risk-free or some-risk base rate: the treasury rate or the prime rate.

The bankruptcy court sided with the farmer that the proper starting point in the case was the treasury rate and, after rounding up, found that a total discount rate of 4% was appropriate and confirmed the plan. The district court affirmed, and the lender appealed to the Eighth Circuit.

On appeal, the Eighth Circuit rejected that the following cases explicitly analyzed the merits of whether the proper base rate for cramdown was the prime rate or treasury rate: *United States v. Doud*, 869 F.2d 1144 (8th Cir. 1989) and *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).

Further, the Eighth Circuit stated that it saw no legal significance to whether a court started with a risk-free rate and added *full* risk or started with a *some*-risk rate and added some more. "If the court properly follows the formula approach, the ultimate discount rate, not the starting point, is what matters," explained the Eighth Circuit.

The Eighth Circuit held that the proper base rate and total discount rate for § 1225(a)(5)(B)(ii) are factual findings based on the particular case.

The Eighth Circuit affirmed the bankruptcy court's factual findings of a 2% base rate and a 2% risk adjustment for a total discount rate of 4%. In its review, the Eighth Circuit discussed that the bankruptcy court considered (1) the length of the proposed maturity period, (2) the fact that the lender's claim was substantially over-secured, and (3) the overall risk of nonpayment. Further, the bankruptcy court specifically noted that the lender's claim was secured by real estate and that those "types of transactions are generally financed over a longer period of time which justifies use of the treasury bond as the base rate."

Eighth Circuit Held Copyright Claims Were Previously Litigated in Bankruptcy Court Proceedings for Sale and Completion of Building

In *Cornice & Rose International, LLC v. Four Keys, LLC*, 76 F.4th 1116 (8th Cir. 2023), the United

States Court of Appeals for the Eighth Circuit ("Eighth Circuit") applied the doctrine of res judicata to hold the architect's copyright claims were precluded because the issues were previously litigated in the bankruptcy proceedings for the sale and completion of the building pursuant to 11 U.S.C. § 363 of the Bankruptcy Code.

The Architectural Works Copyright Protection Act of 1990 extended copyright protection to "architectural works," 17 U.S.C. § 102(a)(8), defined in 17 U.S.C. § 101 as "the design of a building as embodied in any tangible medium of expression, including a building, architectural plans, or drawings."

Pursuant to § 363, the bankruptcy court entered an order authorizing the sale free and clear of the uncompleted building to the primary construction lender in the chapter 7 liquidation over the objection of the architect. The sale order expressly authorized the completion of the building but also expressly stated that the architect's intellectual property may not be used without first making arrangement satisfactory to the architect for the use of its intellectual property. Further, the sale order contained an express reservation of rights for the architect to bring copyright infringement claims in the future.

In a motion to reconsider, the architect argued that the bankruptcy court could not authorize completion of the building because the architect's contract with the debtor for the license to construct the building contained a contingency for full payment. In rejecting the argument on the record, the bankruptcy court described the architect's interest as a security interest and not a stopping measure based on copyright law.

On appeal, the district court dismissed the appeal as moot holding that the lender bought the building in good faith and the sale was not stayed pending appeal. *See* § 363(m) (statutory mootness for failure to timely appeal sale to good-faith purchaser). Before exhausting its appeal rights, the architect filed the lawsuit against the lender and its president, along with the new buyer and its builders, wherein the architect brought the following claims: infringement of the architectural works copyright by finishing the building (Count I), declaratory judgment of copyright infringement for any rental or sale of the building without the architect's permission (Count II), and copyright infringement of technical drawings (Count III).

The district court dismissed Counts I and II holding that the architect failed to allege any copying, the new owner's right to finish the building was protected from a claim of copyright infringement, and Counts I and II were barred by the doctrine of res judicata (claim preclusion). For Count III, the district court granted summary judgment holding the architect failed to demonstrate substantial similarity necessary for copyright infringement, and the completion of the building was not copyright infringement.

In affirming the district court, the Eighth Circuit applied the doctrine of res judicata to hold that Counts I and II were precluded by the bankruptcy proceedings that resulted in the bankruptcy court's orders for the sale and completion of the building. Further, the Eighth Circuit held that the sale was a final judgment for § 363(m).