RECENT DEVELOPMENTS IN CHAPTERS 1, 3, 5, 7, & 13

by

Frank J. Santoro, Esq.
Marcus, Santoro, Kozak & Melvin, P.C.
Portsmouth, Virginia

CHAPTER 1: GENERAL PROVISIONS OF THE BANKRUPTCY CODE

§101(5) – Claim

In the Matter of National Gypsum Co.**,** 219 F.3d 478 (5th Cir. 2000).

The asbestos claimants' trust sought declaratory judgment to establish liability to unknown claimants with the newly-formed purchaser of debtor's operating assets, arguing that the purchaser was the *de facto* reorganized debtor. The court found that the language of the confirmation order and other plan documents did not transfer liability for unknown asbestos claims from the "old debtor" to the "new entity" that was created in the reorganization. Rather, the documents saddled the trust with this liability as the reorganized debtor. Only non-bankruptcy successor liability law governs unknown claimants' rights against the purchaser of the assets*.*

Fogel v. Zell, 221 F.3d 955, 962-963 (7th Cir. 2000).

The chapter 7 trustee moved for approval of proposed settlement that subordinated the late-filed claim of a municipality. Despite the pressure to expand definition of "claim" to clarify asset distribution plans in mass tort litigation, the City of Denver's eligibility to file claim could not result in a penalty for the failure to do so. Where, as here, the name and address of a creditor with a large claim could be readily ascertained by the trustee, notice by publication was neither fair nor reasonable.

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§101(54) - Transfer

In re Feiler, 218 F.3d 948 (9th Cir. 2000).

The chapter 7 trustee brought an adversary proceeding to avoid a debtor's pre-petition election to carry forward net operating losses (NOLs), irrevocable under federal tax law. By so electing, the debtor could offset future income, and waived the carryback and refund. The election was a transfer under §101(54) and could be avoided. Further, while federal law makes the transfer otherwise irrevocable, the trustee's avoidance power trumps the tax law.

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§101(31) - Insider

In re Prado Verde Ranch, Inc., 250 B.R. 126 (Bkrtcy. D.N.M. 2000).

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In denying the trustee's motion for leave to employ a corporation as real estate agent, the Court held that the list of insider relationships set forth in §101(31)(A) and (B) was instructive, but not exhaustive. A family relationship between corporate "professional employee" and debtor can disqualify corporation from employment by the estate despite fact that corporation did not meet the technical definition of "insider." Principal in realty corporation was the step-daughter of principal in debtor corporation.

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§105 - Power of court

Bessette v. Avco Financial Services, Inc., 230 F.3d 439 (1st Cir. 2000).

A former chapter 7 debtor brought an action against consumer finance companies for securing reaffirmation agreements in alleged violation of RICO and state law. In a case of first impression within the First Circuit, the court reversed the district court's dismissal of a §524 proceeding to enforce the discharge injunction, holding that the district court could enforce a private right of action under 524 via the exercise of equitable jurisdiction found in the Bankruptcy Code. The Court declined to "jump into the fray with the complex [legislative intent] analysis…when a remedy is readily and expressly available…" through the equitable powers afforded the bankruptcy court under section 105(a)." 230 F.3d at 444.

Pertuso v. Ford Motor Credit Company, 233 F.3d 417 (6th Cir. 2000).

The Sixth Circuit explicitly declined to follow the First Circuit decision in *Bessette*. Instead, the court divined legislative intent from the 1984 amendments to the Bankruptcy Code that created a private right to sue under §362(h), but did not create a private right to sue under §§363 or 524. 233 F.3d at 422-423, n. 1.

In re Bonham, 229 F.3d 750 (9th Cir. 2000).

In determining the rectitude of consolidating affiliated corporations in a Ponzi scheme case, and with the stated intention of enhancing the fraud avoidance powers of the trustee thereby, the Ninth Circuit decided a number of substantive consolidation issues of first impression**.** Under the "pragmatic approach" to bankruptcy relief adopted by the Ninth Circuit, which recognizes that certain proceedings are so distinctive and conclusive that final decisions as to them should be appealable of right, the court held that an order of substantive consolidation is final and appealable under 28 U.S.C. §158(a), and the decision to order the same *nunc pro tunc* was not an abuse of discretion. In determining the consolidation issue, the court adopted the two-factor test of the Second Circuit and held that "harm" to investors of one company was not sufficient to preclude consolidation. The court held that it could condition the consolidation on the preservation of the trustee's avoidance powers.

In re C.J. Milligan, Inc., 252 B.R. 465, (Bkrtcy. E.D.Mo. 2000).

A chapter 7 debtor moved for an order compelling the IRS to treat chapter 7 payments as payments of trust fund taxes. The court denied the motion, considering itself to possess only the limited authority to order allocation of taxes where bankruptcy purposes would be served thereby. The court distinguished liquidation from reorganization, where bankruptcy purposes afforded broad authority to modify debtor-creditor relationships in reorganization under §§1123(b)(5), 1129, and 105, as recognized in *In re Energy Resources Co., Inc.*, 495 U.S. 545, 548-549, 110 S.Ct. 2139, 2141-2142 (1990). "The Supreme Court's ruling in *Energy Resources Co., Inc*. must be limited to cases that are factually similar." 252 B.R. at 468.

In re Lenke, 249 B.R. 1 (Bkrtcy. D. Ariz. 2000)

The debtor brought an adversary proceeding for a determination of dischargeability and to obtain the injunction of a state court criminal prosecution for theft. The court took the opportunity to discuss the *Rooker-Feldman* doctrine and the “troubled and troubling” recent Ninth Circuit decision in *In re Gruntz*, 202 F.3d 1074, 1085-1087 (9th Cir. 2000). In short, the court could enjoin the state court criminal prosecution under §105, despite the fact that *Gruntz* prevented the “underlying aim” – §362(b)(4) analysis. The dicta in *Lenke* expanded on the *Gruntz* court’s reservation of bankruptcy court authority to enjoin state court prosecutions under §105, extending the power of the court to discharge issues as well as automatic stay issues. 249 B.R. at 7-8.

In re Covington Properties, Inc.**,** 255 B.R. 77, 79-80 (Bkrtcy. N.D.Fla. 2000).

The court sustained objection to the proposed settlement of claims on terms not fair and equitable. An insider faction of creditors, holding 90% of the scheduled debt, proposed the settlement, which would extinguish a state court remedy of the non-insider creditors without conferring a benefit upon them. The bankruptcy court made clear that it considered more than the liquidity of the estate when it determined whether the settlement was fair and equitable.

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§ 106 - Waiver of sovereign immunity

In re Lazar, 2001 WL 29160 (9th Cir. January 12, 2001).

The Ninth Circuit applied a broad “same transaction or occurrence” test, characterized as the “logical relationship” test, to a proof of claim filed by a state agency. The debtors owed a fee to a state agency based on the amount of petroleum they stored, and filed a claim for reimbursement from the state fund comprised of these fees. The state agency had filed a proof of claim for the unpaid fee amount, $13 million. The court denied the state agency’s motion for abstention, holding that the claims for reimbursement from state-administered waste cleanup fund arose from the same transaction or occurrence as the cause for the state’s filing of proof of claim.

May v. Missouri Department of Revenue (In re May), 251 B.R. 714 (8th Cir. BAP 2000).

Missouri’s filing of an answer in an adversary proceeding to determine the dischargeability of tax obligations did not constitute a waiver of its 11th Amendment immunity. Dicta in *Rose v. United States Department of Education*, 187 F.3d 926, 930 n. 7 (8th Cir. 1999), to the effect that “active participation” in a dischargeability proceeding and belated assertion of sovereign immunity are factors to be considered in determining waiver, did not lead the court to a different result, as an answer was not an affirmative request for relief.

In re Bliemeister , 251 B.R. 383 (Bkrtcy. D.Ariz. 2000).

Relying upon a Supreme Court-sanctioned exception to 11th Amendment immunity for admiralty suits in rem, s*ee California and State Lands Comm’n v. Deep Sea Research, Inc.*, 523 U.S. 491, 118 S.Ct. 1464, 140 L.Ed.2d 626 (1998), the court noted the high Court’s recognition of the in rem nature of bankruptcy cases, and held that a proceeding in rem is not a “suit” for purposes of the 11th Amendment.

The court referred to Leonard H. Gerson, *A Bankruptcy Exception to Eleventh Amendment Immunity: Limiting the Seminole Tribe Doctrine*, 74 AM. BANKR. L.J. 1 (Winter 2000), the Federalist Papers, and U.S. Const.. Art. 1, Sect. 8, cl. 4, in discussing the rationale for a lack of state immunity in bankruptcy proceedings. Finally, the Court referred to the state’s filing of a summary judgment motion as waiver. The court considered each ground sufficient for a finding of no sovereign immunity.

Arnold v. Sallie Mae Servicing Corp. (In re Arnold), 2000 WL 1752859 (Bkrtcy. W.D.Tenn. Nov. 27, 2000).

The chapter 7 debtor brought an adversary proceeding to determine the dischargeability of student loans. The defendant, a governmental unit of the state created by the legislature for the purpose of facilitating these loans as guaranteed, filed a motion to dismiss, which was denied. Relying upon the pre-*Seminole* opinion in *In re York-Hannover Developments, Inc.*, 181 B.R. 271 (Bkrtcy. E.D.N.C. 1995), the Gerson article, and additional authorities, the court "believes that the Supreme Court would hold, in the context of a given bankruptcy case under title 11 . . . that section 106(a), as it relates to section 523(a)(8), is a constitutionally valid … abrogation" of sovereign immunity.

Nelson v. La Crosse County District Attorney (In re Nelson), 254 B.R. 436 (Bankr. W.D.Wis. 2000).

"If the Constitution itself contemplated the abrogation of sovereign immunity in a particular area, the Eleventh Amendment does not act to restore the states to their pre-ratification sovereign status." 254 B.R. at 443. The states agreed in the plan of the Constitutional Convention that if Congress elected to act on the subject of bankruptcies, the states surrendered their sovereign powers on the subject. The states' "waiver" of sovereign immunity is reflected in the Constitution itself. *Citing In re Bliemeister*, 251 B.R. 383 (Bkrtcy. D.Ariz. 2000).

In re Hechinger Investment Company of Delaware, Inc.,, 254 B.R. 306, 311-314 (Bkrtcy.D.Del 2000).

The court granted the debtor's motion to declare certain property transfer-tax-exempt, over Maryland's 11th Amendment sovereign immunity objection. In arriving at its decision, the court discussed the Fourth Circuit's decisions in *NVR Homes* and *Antonelli*, attempting to resolve an apparent conflict, and distinguishing between "suits" in which a money judgment or turnover was sought against the state (*NVR Homes*) and requests for prospective relief. Here, no tax had been collected, and the state could choose to participate in the proceeding or not. "That the effect of the ruling precludes Maryland from collecting transfer taxes is a function of substantive federal law, not a violation of its constitutional rights." 254 B.R. at 314.

In re A.H. Robins, 251 B.R. 312 (Bkrtcy. E.D.Va. 2000).

Controlled by the Fourth Circuit's decisions in *NVR Homes* and *Antonelli*, the court, in this case, reached a conclusion different than that reached by the Delaware court in *Hechinger*, above. The debtor's motion for a declaratory determination of the ability to declare NOLs on state income tax return was held to constitute a "suit" against state taxing authorities.

In re Lenke, 249 B.R. 1 (Bkrtcy. D.Ariz. 2000)(also discussed in §105, above).

While the state is immune from adversary proceeding, state actors can be enjoined from future proceedings under *Ex Parte Young* doctrine. ***See also Nelson v. La Crosse County District Attorney*, *supra*; *compare Peterson v. State of Florida*,** 254 B.R. 740 (Bkrtcy. N.D.Ill. 2000)(*Young* doctrine does not permit money damage awards against department of state, only prospective injunctive relief against officers acting in violation of federal law).

***In re Carrington Gardens Associates**,* 248 B.R. 752 (E.D.Va. 2000).

Federal Immunity. Declining to follow *Quality Tooling , Inc. v. United States*, 47 F.3d 1569 (Fed.Cir. 1995), in a federal contract case, the court held that while the Tucker Act may expressly confer jurisdiction on the Court of Federal Claims for breach of contract claims brought against the federal government, it does not unequivocally and expressly waive sovereign immunity for proceedings before a bankruptcy court. Here, the federal government filed a proof of claim and waiver was found despite the lack of Tucker Act waiver.

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§108(b) - Extension of Time.

In re Durability, Inc., 212 F.3d 551 (10th Cir. 2000).

Payment of premium is an act "similar" to cure of default. The §108(b) grace period extends the statutorily-mandated insurance policy grace period for premium payments.

CHAPTER 3: CASE ADMINISTRATION

§303 - Involuntary cases

In re Scrap Metal Buyers of Tampa, Inc., 253 B.R. 103 (M.D. Fla. 2000).

In a case of first impression within the 11th Circuit, the District Court confirmed the appropriate standard of proof to apply to debtor's motion for approval of legal fees following dismissal. A rebuttable presumption of an award of fees arises upon the filing of the fee motion. The burden on the creditors, however, is merely to produce some evidence supporting disallowance of fees. The burden of persuasion at all times resides with the debtor. The court considered the evidence pursuant to a totality of the circumstances approach.

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§323 - Role and capacity of trustee

Carter v. Rodgers, 220 F.3d 1249 (11th Cir. 2000).

A debtor sued the trustee and an antique dealer, alleging breaches of fiduciary duties and duties of reasonable care. Continuing "an unbroken line of cases [imposing this] requirement as a matter of federal common law…" the 11th Circuit held, as a matter of first impression, that a debtor must obtain leave of the bankruptcy court before initiating an action in either state or other federal courts against the trustee, or other court appointed or approved "officer." The leave of bankruptcy court requirement is justified by a policy of preventing myriad, unfounded claims from proceeding against the trustee and other officers.

In re Kids Creek Partners, 248 B.R. 554 (Bankr.N.D.Ill.) ***aff'd, Leighton Holdings, Ltd. v. Belofsky (In re Kids Creek Partners, L.P.)***, 2000 WL1761020 (N.D.Ill. Nov. 30, 2000).

A group of creditors sued the trustee in federal district court for alleged breaches of fiduciary duty and malicious prosecution, arising from the decision of the trustee to challenge, unsuccessfully, a previous stipulation between the creditors and the trustee. After filing in the district court, the trustees "belatedly" brought a motion for leave to sue in the bankruptcy court. The court found that the grounds for the creditors' suit did not make a prima facie case for willful and deliberate breach of fiduciary duty, the 7th Circuit standard for trustee liability, and that the trustee may well have been sued had he failed to challenge the stipulation. Further, under Illinois law, a plaintiff must sufficiently allege "special injury" in order to plead a prima facie case of malicious prosecution, and the plaintiffs plead only the injuries common to litigation. The court refused to relieve the creditors of the requirement that they seek permission on the basis that the statute of limitations was about to run.

See also In re Weisser Eyecare, 245 B.R. 844 (N.D.Ill. 2000)(trustee can only be held liable for “ultra vires” actions and breaches of fiduciary duty).

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§327 - Employment of professional persons

David R. Kittay v. Daniel J. Kornstein, et al., 230 F.3d 531 (2nd Cir. 2000).

The chapter 7 trustee alleged breaches of fiduciary duty, contract-breach, and legal malpractice arising from debtor’s counsel’s representation of both the debtor and a competing creditor in a state court collection proceeding. The appeals court affirmed the dismissal of the complaint insofar as it alleged an improper conflict. The retention and escrow order of the bankruptcy court cured the conflict in this case by resolving the rivalry over the judgment by the two creditors with common counsel. The court cautioned that such orders may not necessarily be sufficient to cure conflicts in every instance, citing the fact-specific nature of such disputes.

In re Albrecht, 233 F.3d 1258 (10th Cir. 2000).

In a case transferred from California to Wyoming, California counsel started work for the trustee prior to court approval, and applied retroactively for employment. The Wyoming court denied this application, but later accepted the firm’s application for employment as special counsel, and approved these fees. The special counsel then sought to obtain the fees it generated prior to and during the time their first application for employment was pending with the court, and sought to have these expenses declared administrative expenses. In a case of first impression in the 10th Circuit, the appellate court held that the firm, denied “post facto” fee approval, was not entitled to administrative expense priority for fees generated prior to and during the time its motion for approval was pending.

In re Water’s Edge Limited Partnership, 248 B.R. 668 (D.Mass. 2000).

This case involved the sale of the real estate asset in a single asset real estate case. Creditors alleged a conflict of interest in the debtor’s counsel’s prior representation of an insider, in an insider purchaser case. The district court was not satisfied with the dearth of bankruptcy court explanation in support of its finding of no conflict of interest. The bankruptcy court sits on the front line of the judiciary, and must examine and present fact-findings in support of both disinterestedness and a lack of adverse interest pursuant to §327. A disinterestedness determination does not rest on proof of a lack of actual conflict; rather it is properly supported by a finding of the absence of a perception of conflict.

See also In re Princeton Medical Management, Inc., et al., 249 B.R. 813 (Bankr. M.D.Fla. 2000)(accountant refused to waive prepetition fee, failed to meet burden of disinterestedness, and therefore court refused to accept retroactive application where applicant failed to prove application would have been accepted in the first place).

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§328 - Limitation on compensation of professional persons

In the Matter of Texas Securities, Inc., 218 F.3d 443 (5th Cir. 2000).

The bankruptcy court approved the employment of trustee's special litigation counsel pursuant to an Employment Order that provided a fee of 40% of assets recovered by such counsel. The bankruptcy court reduced the final fee award pursuant to the lodestar formula set forth in §330, and the district court affirmed this decision. The appeals court reversed. If a court approves a fee structure, only a limited inquiry under §328, for unforeseen circumstances, is undertaken in review of subsequent fee applications. On the other hand, if fees are not prior-approved, applications for payment thereof remain subject to the Section 330 test for reasonableness and benefit to the estate.

Daniels v. Barron (In the Matter of Barron), 225 F.3d 583 (5th Cir. 2000).

The unforeseen circumstance sufficient to adjust a prior-approved fee structure must have been incapable of being anticipated at time of approval.

In re B.U.M. International, Inc., 229 F.3d 824 (9th Cir. 2000).

The bankruptcy court approved a consultant's fee structure, but retained the right to approve the actual fees. While the appeals court did not recommend the bankruptcy court approach, the bankruptcy judge had the authority to give qualified approval to a fee structure and reserve §330 power to approve fees generated thereunder. The bankruptcy court exercised its power to review, as reserved in the prior order, and the resulting decision to completely deny (*i.e.*, no reduced fee) the fee application for lack of benefit to the estate did not constitute "clear error." This case discussed and declined to follow the 5th Circuit's opinion *Donaldson, Lufkin & Jenrette Sec. Corp. v. National Gypsum Co. (In re National Gypsum Co.)*, 123 F.3d 861 (5th Cir. 1997).

In re Pittsburgh Corning Corp., 255 B.R. 162 (Bankr. W.D.Pa. 2000).

In a mass-tort mega-chapter 11, over the objection of the United States Trustee, the court entered an administrative order providing for monthly conditional interim fee payments without prior hearing approval. The payments would only be subject to later review and possible disgorgement. The court considered the monthly hearings on debtor's fee applications "uneconomical, inefficient and burdensome to the parties and the court. ***See also In re Mariner Post-Acute Network, Inc., et al.*** (Bankr.D.Del. 2000).

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§362 - Automatic Stay

In re Pettitt, 217 F.3d 1072 (9th Cir. 2000).

The debtors sued to recover for an alleged violation of the stay. Judgment creditors withdrew funds held by a non-bankruptcy federal court as security in the event the debtors lost at trial. The non-bankruptcy court entered the disbursement order pre-petition. The debtors argued that the funds could have been used for the appeal bond, and had previously been used, with the approval of the non-bankruptcy court, for payment of attorneys' fees. The disbursement order extinguished the debtors' rights in the funds. Had the debtors requested that the funds be used as a supersedeas bond, and an order been entered providing for such, a right could have been re-created. As it stood, without such an order, the funds never became property of the estate, and the judgment creditor's withdrawal of the funds from the court registry was not a violation of the stay.

NextWave Personal Communications Inc. v. FCC (In re NextWave Communications)**,** 217 F.3d 125 (2d Cir.2000), cert. denied, ___U.S.___, 121 S.Ct. 606, ___L.Ed.2d ___, 2000WL 1377133 (U.S., Nov. 27, 2000).

Prior to filing bankruptcy, NextWave believed it overpaid for FCC licenses purchased at auction for $4.74 billion. When non-bankruptcy measures to undo the auction were unsuccessful, NextWave filed bankruptcy. The debtor immediately attempted to undo the auction sale as a constructively fraudulent conveyance. In reversing the lower courts' avoidance of the transaction as constructive fraud, the Second Circuit held that the auction process was a regulatory procedure over which the FCC had exclusive jurisdiction. According to the appeals court, "even where the regulatory conditions imposed on a license take the form of a financial obligation, the bankruptcy and district courts lack jurisdiction to interfere in the FCC's [license] allocation."

After the appellate order came down, the debtor had a change of heart, amending its plan of reorganization to provide for full payment to the FCC of the auction price. In fact, the debtor sweetened the deal for the FCC, offering to pay the entire amount in lump sum.

The day after the sweetening, the FCC noticed the re-auction of the licenses. The debtor moved to have the notice declared null and void, and the bankruptcy court granted the motion. The court found that the licenses constituted property of the estate, that the debtor had the opportunity to cure default and/or that no default occurred because the debtor could not pay the FCC without court approval, and that the FCC was estopped from claiming that the licenses were forfeit as a result of its prior positions.

On the petition for mandamus filed by the FCC, the appeals court found in favor of the FCC in each instance: the bankruptcy court could not undo the transfer as a fraudulent conveyance (when the debtor believed the value of the license was lower than the auction price) nor could it void the notice of re-auction (after the debtor realized it had *not overvalued* the licenses at the time of auction). The jurisdiction of the FCC over the licenses and auction procedure was exclusive, and the FCC decision, arbitrary or not, was outside the limited jurisdiction of the bankruptcy court.

See also United States v. Kansas Personal Communications Services, Ltd. (In re Kansas Personal Communications Services, Ltd.), 2000 WL 1909781 (automatic cancellation of licenses by FCC not an "act" subject to the stay, and would be excepted from stay under 362(b)(4) in any event under 10th Circuit test); ***In the Matter of GWI PCS 1, Inc***., 230 F.3d 788 (5th Cir. 2000).

Securities and Exchange Commission v. Brennan, 230 F.3d 65 (2nd Cir. 2000).

A judgment debtor in a multi-million dollar investment scam created off-shore trusts post-petition, and neglected to include them in his schedules. Court-ordered enforcement of the money judgment obtained by the SEC is an exception to the exception from the stay found in 362(b)(4) and constituted a violation of the automatic stay.

Gruntz v. County of L.A. (In re Gruntz), 202 F.3d 1074 (9th Cir. 2000).

The Ninth Circuit Court of Appeals refused to apply the "underlying aim" analysis to a prosecutor's attempt to enforce child support payments by a criminal contempt proceeding, and would not void the criminal prosecution of the bankrupt defendant on that basis. The Court discussed bankruptcy courts' authority to consider state court determinations of application of the automatic stay under the *Rooker-Feldman* doctrine. The *Gruntz* decision has been termed "troubling" in a subsequent bankruptcy court decision in the Ninth Circuit. ***Lenke v. Tischler,*** 249 B.R. 1, Bkrtcy. D.Ariz. 2000).

In re Aquarius Disk Services, 254 B.R. 253 (Bankr. N.D. Cal. 2000).

The creditors under a lease obtained an attachment lien pre-petition. In a case of first impression within the 9th Circuit, the bankruptcy court held that the creditor could liquidate and perfect a prepetition attachment lien by means of the state court proceeding. Once such rights were perfected, however, enforcement of the judgment lien would be stayed.

In re the Bennett Funding Group, 255 B.R. 616 (N.D.N.Y. 2000).

When the bankruptcy court lifted the stay to a specific subset of collateral, it did not address the bank's remaining arguments concerning other collateral. Four years later, the banks argued that the stay was terminated with regard to this "other collateral" as the express timing mandates of 362(e) were not met, i.e., a preliminary hearing within thirty days of filing, and a final hearing within sixty. The district court found that a status conference provided sufficient evidence of compelling circumstances for extension of the deadlines for final hearings. An Omnibus Order reflected the compelling circumstances found by the court. The "numerosity and the burden" on the "Debtors and/or the Trustee" of 240 bank motions for relief constituted the compelling circumstances.

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§361 - Use, Sale or Lease of property

In re Weisser Eyecare, 245 B.R. 844 (N.D.Ill. 2000).

Settlement of an estate cause of action is a use, sale, or lease of property outside the ordinary course of business, and requires notice and hearing. The trustee's failure to provide such notice, however, did not render the settlement an ultra vires act. Thus, the trustee could not be held liable for the terms of the settlement under Seventh Circuit precedent.

Wintz v. American Freightways, Inc., 219 F.3d 807 (8th Cir. 2000).

The trustee sold real estate from the estate to a bona fide purchaser. A prior transferee, whose transfer the trustee had avoided, objected to the sale. The objector questioned the finality of the sale in light of contingencies within the contract. None of these contingencies, however, vested any third party with enforceable rights. Although one clause made the contract contingent on the expiration of the time for appeal rights, and the court confronted such an appeal, the parties closed the sale. In fulfilling their obligations under the contract, each extinguished the right of the other to withhold performance. Thus, the finality rule prevented any person from overturning the sale.

The trustee included a "last look" provision in the bidding process, pursuant to which the putative purchaser could submit a new bid upon objection to the adequacy of the final bid. The court upheld this provision. Finally, the court held that amended sales terms, lowering the bid price substantially, did not require 20-day notice. The initial notice of sale met the statutory requirements, and the amended notice was likewise served on all parties in interest, including the other high bidders. The new notice concerned the same sale, and was sufficient (13 days) to allow new bids to be submitted.

Folger Adam Security, Inc. v. Dematteis/MacGregor, JV, 209 F.3d 252 (3rd Cir. 2000).

A pre-petition dispute arose between a contractor and the debtor-supplier. The debtor purported to notice the sale of its assets, and indeed sold its assets during the bankruptcy proceedings. Thereafter, the debtor brought a breach of contract action against the contractor, alleging that the affirmative defenses of the contractor were extinguished as an "interest" in the debtor's property sold after notice and hearing. The court disagreed. Defenses are not an "interest" under §363(f). Further, the notice of sale of the debtors assets was constitutionally inadequate to inform contractor that it would lose its defenses pursuant to the sale. The affirmative defenses of recoupment and setoff were not extinguished.

In re Roberts, 249 B.R. 152 (Bankr.W.D.Mich. 2000).

At hearing on the trustee's properly noticed motion to sell, one of four lienholders appeared in support of the motion, and one had previously settled an objection to the proposed sale. The court inquired as to the two lienholders not present, specifically asking if they had assented to the sale. The trustee took the position that both lienholders implicitly consented by their failures to timely object.

The court held that consent cannot to be implied by a lienholder's failure to object to a motion to sell property of the estate. "Consent" is not the synonym of "fails to object." This states the minority position. In questioning the justification for the majority rule, which finds implied consent from a failure to timely object, the court traced its origins to *Pelican Homestead v. Wooten (In re Gabel)*, 61 B.R. 661, 667 (Bkrtcy.W.D.La. 1985), then distinguished the facts before it from the facts presented in *Gabel*, where the court had considered a sale of assets consummated a year prior to the filing of the objection to sale.

In re Quanalyze Oil & Gas Corp., 250 B.R. 83 (W.D.Tex. 2000).

The wife of the chapter 11 debtor's principal moved for stay and reconsideration of the order approving sale of the debtor's property, alleging her arrangement of a better offer. She filed the motion on the day of closing, one day after entry of the order approving sale.

Prior to December 1, 1999, sale orders were final upon entry, and could only be prevented from becoming operative by obtaining an immediate stay. The court, in *Quanalyze,* observed that amended rules 6004, 7062, and 9014 now stay sale orders, by operation of law, for 10 days, unless otherwise ordered. This window, according to the court, greatly increases the risks to parties to a sale in bankruptcy, potentially leading to endless litigation.

The court indicated it would not have found the proffer of a "better offer" sufficient to justify reconsideration in any event. "Were parties permitted to run in bids after the close of the sale hearings, then bidders themselves would quickly realize that they were being used as a stalking horse, while other bidders waited for the stalking horse to set the price range, before committing themselves to a bid." 250 B.R. at 91.

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§365 - Executory contracts and unexpired leases

In re National Gypsum, 208 F.3d 498 (5th Cir. 2000).

The asbestos-product manufacturer debtor filed a plan under chapter 11 in which it purported to assume contract liability to an insurer as an executory contract. The liability arose as a result of an omnibus settlement of indemnity liability and related disputes. The plan set forth $0 as the amount necessary to cure its default under the contract with the insurer. Subsequent to plan confirmation, the debtor sought to have the assumed $0 obligation declared to be discharged pursuant to §1141(d) because the insurer failed to file a proof of claim, despite sufficient notice of the bankruptcy, and because §1141(d) provides for the discharge of debts that arise prior to confirmation. The Court held that a debt assumed does not give rise to a claim or evidence a previous debt, presupposing cure of any default, hence the insurance company's claim was neither discharged nor waived. Only a *rejected* executory contract gives rise to a claim.

Sir Speedy, Inc. v. Morse, ___ B.R. ___, 2000 WL 1900283 (D.Mass. 2000).

The franchisor moved for relief from stay to enforce rights under a covenant not to compete found in its franchise agreement with the debtor. The bankruptcy court held that the trustee's rejection of the agreement resulted in a termination of all obligations under the franchise agreement including the covenant not to compete. The district court disagreed, finding that rejection is properly treated as and considered a breach, and not wholesale termination. The covenant not to compete was intended to govern the relationship between the parties after the demise of the contract, and survived rejection.

CHAPTER 5: CREDITORS, THE DEBTOR, AND THE ESTATE

THE SUPREME COURT

Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A., 530 U.S. ____, 120 S.Ct. 1942 (2000).

The debtor in this case failed to pay premiums for its workers' compensation insurance coverage which arose post-petition. After conversion to Chapter 7, the carrier, recognizing that the estate lacked sufficient unencumbered assets to pay the premiums, filed an application with the court for payment of its administrative expense claim and to charge the expense against the collateral of the debtor's secured creditor, pursuant to **§506(c)**.

Invoking the now-familiar rule that statutes should be given their plain meaning, unless to do so would create an absurd result, Justice Scalia, writing for a unanimous Court, held that as §506(c) conferred the right to surcharge collateral solely upon "the trustee," it is only "the trustee" who may do so. Although there is some evidence that pre-Code practice may have permitted others to surcharge collateral, the Court refused to say that this was implicitly carried forward after enactment of the Code.

Raleigh v. Illinois Department of Revenue, 530 U.S. ____, 120 S.Ct. 1951 (2000).

Resolving a deep split among the circuits, Justice Souter, writing, again, for a unanimous Court, held that the burden of proof in determining a claim in bankruptcy, including a tax claim, under **§505(a)**, is the same as it would be outside bankruptcy, unless specifically altered by Congress. Thus, agreeing with the Third, Fourth and Seventh Circuits and rejecting the positions taken by the Fifth, Eighth, Ninth and Tenth Circuits, the Court ruled that if state law places the burden of proof on a taxpayer regarding liability for a tax, the same burden will apply if the issue is decided by a bankruptcy court.

OTHER DEVELOPMENTS

§502 – Informal proof of claim

Barlow v. M. J. Waterman & Assoc., Inc. (In re M. J. Waterman & Assoc., Inc.), 227 F.3d 604, 36 BCD ¶212 (6th Cir. 2000).

In the mistaken belief that the filing of motions prior to the bar date obviated the need to do so, a creditor failed to comply with the requirements of §502 with respect to a formal proof of claim. Later, he argued that his pleadings should be considered an informal proof of claim. The bankruptcy court disagreed and denied the creditor's motion.

The Court of Appeals held that although the creditor satisfied the first four requirements of the common law doctrine of informal proof of claim (*i.e.*, that it be in writing; that the writing must contain a demand on the estate; that the writing must express an intent to hold the debtor liable for the debt; and that the writing must be filed with the bankruptcy court), he failed to persuade the bankruptcy court that granting the motion would be equitable under all the circumstances of the case, the critical fifth element of the doctrine. This determination is committed to the discretion of the bankruptcy court, to be reversed only for abuse.

§503(b)(1) – Administrative expense – economic benefit

In re Beverage Canners International Corp., 255 B.R. 89, 36 BCD ¶267 (Bkrtcy. S.D.Fla. 2000).

After filing its Chapter 11 petition, the debtor continued to imprint its products with the Nature Conservancy's trademark, pursuant to a licensing agreement entered into before bankruptcy. The debtor maintained that it derived no measurable economic benefit from doing so, although the evidence did show that it would have cost the debtor $60,000 to remove the trademark from the engraving plates it used to print its labels. Rejecting the argument that it should independently value the consideration provided for under an executory contract where there is no contrary evidence to the bargained for contractual rate, the court held that proof of the debtor's actual economic benefit was not necessary to enable the claimant to assert an administrative expense priority claim based on the pre-petition contract royalty rate. The debtor may not accept the benefit of a pre-petition executory contract without also accepting the burdens.

§503(b)(4) – Compensation of professionals – substantial contribution

Speights & Runyan v. Celotex Corp. (In re Celotex Corp.)**,** 227 F. 3d 1336, 36 BCD ¶213 (11th Cir. 2000).

A law firm which represented individual creditors in a complex Chapter 11 case and whose efforts were, by all accounts, critical to the reaching of confirmation of a consensual plan of reorganization, was entitled to compensation from the estate, notwithstanding the fact that it represented interests adverse to the estate, based on its having made a substantial contribution to the case. Rejecting the position taken by the Third and Tenth Circuits, the court agreed with and adopted the position of the Fifth Circuit that a creditor's motives in taking actions which benefit the estate are of little relevance in determining whether those actions made a substantial contribution to the case. The creditor need not be motivated by altruism in order to be given administrative expense status.

§507(a)(4) – Priority – contributions to employee benefit plan

Travelers Property Casualty Corp. v. Birminham-Nashville Express, Inc. (In re Birmingham-Nashville Express, Inc.), 224 F.3d 511, 36 BCD ¶139 (6th Cir. 2000).

Premiums incurred within 180 days of bankruptcy for state-mandated workers' compensation insurance were not contributions to an employee benefit plan and, therefore, were not entitled to priority under §507(a)(4). In the first place, such premiums are not contributions, because that "does not describe a unilateral purchase of some product or service."

Secondly, workers' compensation insurance coverage is not an employee benefit plan within the meaning of §507(a)(4). This holding is consistent with decisions by the Eight and Tenth Circuits. The term, "employee benefit plan," these circuits hold, should be limited to "bargained-for substitutions for wages." Also, the incorporation of the ERISA definition of "employee benefit plan" is improper and inappropriate.

The Ninth Circuit takes a different view. It considers workers' compensation insurance to be an employee benefit plan, although it expressly declined to decide whether the ERISA definition should be used.

§507(a)(8) – Tax priority

PBGC v. Belfance (In re CSC Industries, Inc.), 232 F.3d 505, 36 BCD ¶284 (6th Cir. 2000).

The Pension Benefit Guaranty Corporation was not entitled to claim priority, under §507(a)(8), for missed minimum funding contributions to a pension plan when the lien authorized under §412(n)(4) of ERISA was not imposed due to operation of the automatic stay. Had the lien taken effect prior to the filing of the debtor's petition, it would have been treated as taxes, giving the claim the desired priority.

§521 – Duty to cooperate with trustee
§554 – Abandonment

Vasquez, Trustee v. Adair (In re Adair), 253 B.R. 85, 36 BCD ¶205 (9th Cir. BAP 2000).

The debtor listed a personal injury lawsuit in her schedules, showing it to be of uncertain value but exempting it with a value of $20,000.00. The trustee inquired of the personal injury lawyer about the case and was informed that recovery was speculative, at best. The trustee made no further inquiries, filed a no asset report and closed the case. The personal injury claim was later settled for $430,000.00.

Three years after the case was closed, the trustee moved to re-open it and revoke abandonment of the tort claim. The bankruptcy court denied the motion and the BAP affirmed.

The debtor did not have a continuing duty to provide the trustee with updates regarding assets disclosed in her schedules, in the absence of requests by the trustee. Section 521 does not go that far in requiring a debtor to cooperate with the trustee.

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§522 – Exemptions

Bell v. Bell (In re Bell), 225 F.3d 203 (2nd Cir. 2000).

In a case of first impression at the court of appeals level, the Second Circuit held that the conversion of a Chapter 11 case to Chapter 7 does **not** provide a new opportunity for objecting to exemptions claimed by the debtor at the commencement of the Chapter 11 case. This ruling was contrary to holdings of most bankruptcy courts which have addressed the issue, including the Northern District of Ohio (*In re Havanec*, 175 B.R. 920), the Southern District of New York (*In re Kleinman*, 172 B.R. 764), the Middle District of Florida (*Matter of Bergen*, 163 B.R. 377), the Eastern District of Virginia (*La Rossa v. Leydet (In re Leydet)*, 150 B.R. 641) and, very recently, the Eastern District of Michigan (*In re Wolf*, 244 B.R. 754). There was a strong dissent, suggesting that a split among the circuits may arise before too long.

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§523(a)(2)(A) – Exceptions to discharge – fraud – justifiable reliance

AT&T Universal Card Services v. Mercer (In re Mercer), 211 F.3d 214 (5th Cir. 2000), *reargued en banc* (September 21, 2000) (No. 98-60693).

The debtor was offered and accepted a pre-approved credit card from the creditor. Within a month, she had exceeded her credit limit, primarily with cash advances, some of which were at casinos. The creditor sought to except the debt from discharge, upon the grounds of fraud or misrepresentation other than by use of a written statement of financial condition, but the bankruptcy court and district court ruled in favor of the debtor, on the grounds that she had made no representations to the creditor regarding her creditworthiness upon which the creditor could have relied.

All three judges on the panel wrote opinions, two of which sided with the debtor, for different reasons. Judge Duhé, writing for the court, expressly agreed with the lower court decisions. He noted that “justifiable reliance” presupposes that there has been actual reliance on misrepresentations, which cannot have occurred in this instance, as the debtor made none. The decision to extend a credit agreement to the debtor was based on the creditor’s use of third-party selection criteria and its own investigations. In addition, Judge Duhé specifically rejected the “implied representation” theory, which states that every time a debtor uses a credit card, an implied representation of intent and ability to repay is made. He also criticized the credit card industry for its irresponsible credit-granting practices and pointed out that this ruling would require credit card companies to act more appropriately in making its decisions on issuing cards in the first place.

Judge Dennis wrote an opinion in which he concurred specially with the opinion of the court. In his view, (1) when a credit card is used, the holder impliedly promises to repay the loan; but (2) a credit card company cannot justifiably rely on every card user’s representation just because the card was used; therefore (3) a creditor which issues cards without making an adequate assessment of the debtor’s credit history and financial condition cannot claim that the simple use of a card it issued constitutes a representation of intent to pay on which there can be justifiable reliance; however (4) over a period of time there may develop a basis for the creditor’s belief that the mere use of a credit card *is* a representation upon which it may justifiably rely. However, given the very short period of time between issuance and cancellation of the card, this creditor could not derive comfort from this analysis in this case. Moreover, even if there were an implied representation of ability and intent to repay, the debtor must know such representation is false at the time it is made or otherwise have specific intent to deceive in order for the elements of §523(a)(2)(A) to be satisfied. Here, the creditor assumed the risk of non-payment by issuing a pre-approved card on meager credit information.

Judge Barksdale wrote in dissent, noting that the opinion written by Judge Duhé would make it virtually impossible for any issuer of a pre-approved credit card to prevail in a §523(a)(2)(A) action. Additionally, Judge Barksdale felt strongly that the Bankruptcy Code "should *not* be interpreted to require a creidtor who investigagtes a debtor's credit history prior to making a pre-approved solicitation, as AT&T did in this case, to assume the risk of the debtor committing fraud in subsequently using the card." Judge Barksdale would have held (1) that each use of the credit card constituted an express representation by the debtor of intent to repay, at least by making minimum payments; (2) that the trial court must make findings on the debtor' subjective intent to deceive, based on available objective evidence of state of mind; (3) that, in accordance with the Ninth Circuit's view, a credit card issuer justifiably relies on a representation of intent to repay as long as an account is not in default and its initial investigations of the debtor do not raise any red flags; and (4) that the creditor's loss was proximately caused by its reliance on the debtor's promise to repay charges incurred each time the card was used.

Judge Barksdale urged rehearing *en banc* and, upon AT&T's petition, rehearing was granted. Argument was conducted on September 21, 2000.

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§523(a)(2)(A) – Exceptions to discharge – fraud – receipt of benefits

National Development Services, Inc. v. Denbleyker (In re Denbleyker), 251 B.R. 891, 36 BCD ¶193 (Bkrtcy. D.Colo. 2000).

The debtor was the general manager for a construction subcontractor who had sent written payment applications to a general contractor, falsely representing that all of the subcontractor's own suppliers and subcontractors had been paid and that its work was complete. The purpose of the misrepresentations was to enable his employer, the subcontractor, to be paid. There was no evidence in the record of the debtor's having directly benefited from the misrepresentation. Under long-held case law, the "receipt of benefits" doctrine would have resulted in the creditor's dischargeability action's having been dismissed. The bankruptcy court found, however, that the doctrine had been abrogated by the Supreme Court's decision in *Cohen v. de la Cruz*, 523 U.S. 213, 113 S.Ct. 1212 (1998). The "receipt of benefits" interpretation of §523(a)(2)(A) wrongly imposes additional limitations on the application of the statute and is in conflict with the policy of the fraud exception, which *Cohen* said is expansive. Once a plaintiff establishes that a debtor caused money or property to be obtained by fraud, any debt arising from the fraud is excepted from discharge, even if the debtor, himself, received no direct benefit.

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§523(a)(2)(B) – Exceptions to discharge – reasonable reliance

Shaw Steel, Inc. v. Morris (In re Morris), 223 F.3d 548, 36 BCD ¶165 (7th Cir. 2000).

Affirming the trial court's judgment, the Seventh Circuit held that while "the concept of reasonable reliance does not generally require creditors to conduct an investigation prior to entering into agreements with prospective debtors, such a precaution could be the ordinarily prudent choice in circumstances where the creditor admits that it does not believe the representations made by the prospective debtor." The bankruptcy court had made the factual finding that the creditor's reliance on the debtor's statement of financial condition was unreasonable, given the circumstances of the case, which finding could not be viewed as clearly erroneous.

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§541 – Property of the estate
§544(b) – Avoidance powers – strong-arm

Official Committee of Unsecured Creditors v. Chinery (In re Cybergenics Corp.), 226 F.3d 237, 36 BCD ¶190 (3rd Cir. 2000).

Two years after being saddled with cruising debt in a leveraged buy-out, the debtor filed for relief under Chapter 11. Shortly thereafter, it agreed to sell nearly all of its assets to a third party. A sale was subsequently approved by the bankruptcy court. The debtor then sought to dismiss its case, but the Creditors' Committee objected, contending that the LBO could have created fraudulent transfer claims which should be pursued. The court allowed the committee to investigate and pursue the claims but the district court, on appeal, granted the defendants' motions to dismiss, holding that claims arising out of the LBO had been sold by the debtor in the post-bankruptcy sale of its assets.

The Third Circuit held that, under New Jersey's UFTA, the fraudulent transfer causes of action belonged to the creditors who were the victims, not to the debtor. Thus, they were not property of the estate which could be sold. The fact that §544 authorizes a DIP to avoid a transfer using a creditor's fraudulent transfer cause of action does not mean that the cause of action is an asset of the DIP, nor should it be confused with the separate authority of a DIP to pursue the pre-petition debtor's causes of action which *are* property of the estate.

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§547 – Preferences

Hays, Trustee v. DMAC Investments, Inc. (Matter of RDM Sports Group, Inc.), 250 B.R. 805, 36 BCD ¶135 (Bkrtcy. N.D.Ga. 2000).

Debtor was in default under a commercial lease. Lessor filed suit and took judgment for distress and damages. A public sale was scheduled but never took place, as the parties entered into a settlement. Within 90 days after paying the settlement amount, the debtor filed for Chapter 11 relief. The Chapter 11 trustee sued to avoid and recover the settlement payment as a preferential transfer.

The court rejected the lessor's arguments that the transfer was made other than for or on account of an antecedent debt. The fact that a sheriff's sale was imminent at the time that the transfer occurred made it hard for the court to believe that it was in satisfaction of future lease obligations. The court seemed to indicate that a transfer in consideration of release of a judgment lien *might* have been other than payment for or on account of an antecedent debt, but the lien was never actually released in this case, making the point moot. Finally, settlement of a claim represented by a judgment is not new consideration. The debt already existed when the settlement was made and the transfer occurred.

The lessor also argued that it did not receive a preference because it was a secured creditor and the transfer was made in satisfaction of its lien; therefore, it said, it did not receive more than it would have received had the transfer not been made and its only recovery had been in a hypothetical chapter 7 distribution. The court began by noting that unless creditors will receive a 100% distribution, any unsecured creditor who receives a payment during the preference period is in a position to recover more of his claim that would have occurred in a chapter 7 liquidation scenario. The lessor's lien status did not improve its case, however, because the judicial lien arose with the preference period, as well. Because the judicial lien, itself, was an avoidable preference, it could not be used to elevate the claim from unsecured status.

Lastly, the court rejected the claim that the lessor gave new value for the transfer in forbearing to enforce its judgment. Neither forbearance from exercising pre-existing rights nor releasing a debtor from its contractual obligations constitutes new value, for purposes of preference analysis.

CHAPTER 7: LIQUIDATION

SUBCHAPTER I: OFFICERS AND ADMINISTRATION

§702 – Election of Trustee

***In re USA Capital, LLC,* 251 B.R. 883** (Bankr. D. Col. 2000)

The Bankruptcy Court sorts out the results of a disputed Chapter 7 Trustee election and concludes that none of the creditors who voted at the election were eligible to vote, primarily because they all held disputed claims. The Court disqualified all votes and held that, pursuant to 11 USC §702 (d), the interim Trustee shall continue to serve as Trustee in the case.

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§704 - Duties of Trustee

***In re Barman,* 252 B.R. 403** (Bankr. E.D. Mich. 2000)

In carrying out his duties to investigate a debtor's financial affairs and to account for, collect and reduce to money, property of the estate, a chapter 7 Trustee filed an adversary proceeding seeking to avoid numerous transfers from the debtor to his wife. The trustee also obtained an ex parte order authorizing him to enter the debtor's residence to inspect, inventory and appraise personal property located there. The trustee carried out the inspection and the debtor moved to suppress the evidence obtained by the trustee on the grounds that the inspection violated his Fourth Amendment rights against unreasonable search and seizure. The bankruptcy court agreed that, because the chapter 7 Trustee is appointed and supervised by an official of the Department of Justice, a trustee is subject to the restrictions of the Fourth

Amendment. The court determined, however, that the trustee's behavior in the search was not unreasonable and denied the motion to suppress.

***In re Lufkin,* 255 B.R. 204** (Bankr. E.D. Tenn. 2000)

Prior to filing his chapter 7 case, the debtor had requested the Tennessee Supreme Court transfer his law license to "disability inactive status." The debtor had been engaged in the practice of law under his own name, under a professional corporation and under a partnership. A receiver had been appointed to take possession the property of the law practice of the various entities. The trustee had filed a motion for a Rule 2004 Exam and sought records from the receiver relating to the financial affairs of the debtor and various law firms. The Bankruptcy Court easily disposed of the debtor's challenges to the subpoena on Fourth, Fifth & Sixth Amendment grounds. The Court held that Trustee's search was reasonable within the limits of the Fourth Amendment because he was acting within his statutory authority and upon the Court's permission. The Court noted that a "'reduced expectation of privacy is a natural consequence of the substantial and detailed disclosures that are inherent in the bankruptcy process.'" Regarding the Fifth Amendment challenge, the Court noted that compelling production by a third party does not violate Fifth Amendment Rights against self-incrimination. The Court rejected the Sixth Amendment challenge on the grounds that Sixth Amendment protection is limited to criminal proceedings and does not cover a Rule 2004 Examination.

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§706 – Conversion

***In re Mosey,* 244 B.R. 79** (Bankr. E.D. Va. 2000)

A Chapter 13 Trustee moved to dismiss the cases of three different debtors who moved to convert their Chapter 7 cases to ones under Chapter 13 only after receiving a Chapter 7 discharge. The Court refused to establish "an absolute rule that would bar a debtor from converting to Chapter 13 after having received a Chapter 7 discharge in the same case." The Court noted, however, that such instances often "will strongly suggest an attempt to abuse the bankruptcy process." Such procedural maneuverings can be grounds for denial of confirmation, and reconversion of the Chapter 13 case to one under Chapter 7 pursuant to 11 U.S.C. §1307(c)(5). The Court also denied the debtors' motions to revoke their Chapter 7 discharge. The Court concluded that revocation of discharge is only appropriate on grounds articulated under Rule 60(b), Fed.R.Civ.P., as incorporated by Rule 9024, Fed.R.Bankr.P. The Court concluded that the proper avenue of consideration was the debtor's Chapter 13 plans, especially the good faith test of §1325(a)(3) and liquidation test of §1325(a)(4).

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§707 – Dismissal

***In re Tamecki,* 229 F.3d 205** (3rd Cir. 2000)

The Third Circuit affirmed dismissal of Debtor's chapter 7 case for lack of good faith for filing on the eve of his divorce and dissolution of his entireties interest in the marital home. With approximately $100,000.00 in equity in his home and a discharge of a $35,000.00 credit debt, the court acknowledged that the reasonableness of the accrual of the debt and the timing of his filing, particularly in relation to the curious and unexplained circumstances relating to the divorce proceeding, were "sufficiently questionable" to warrant scrutiny.

***In re Taylor,* 212 F.3d 395** (8th Cir. 2000)

The Court of Appeals for the 8th Circuit upheld the Bankruptcy Court's decision to dismiss a debtor's Chapter 7 case on the grounds of "substantial abuse" under §707(b). The Appellate Court concluded that even though income from an ERISA qualified pension was exempt, it should be considered as disposable income for purposes of evaluating whether a debtor has the ability to fund a Chapter 13 plan.

In re Padilla, **222 F.3d 1184** (9th Cir. 2000)

The office of the US Trustee moved to dismiss a debtor's chapter 7 case on grounds of a credit card "bust-out." The 9th Circuit concluded that bad faith does not constitute "cause" for dismissal of a chapter 7 petition. The court limited "bust-out" objections to debtor's petitions to consideration under §707 (b) and held that the bankruptcy court's dismissal of the petition pursuant to subsection (a) for lack of good faith was improper.

In re Engskow, **247 B.R. 314** (Bankr. M.D. Florida 2000)

The court followed the "totality of the circumstances test" and evaluated the factors outlined by the Fourth Circuit in In Re Green, 934 F.2nd 568 (4th Cir. 1991). The court concluded that it was proper to consider the non-filing spouse's income when evaluating the factors. The court concluded that the debtor was maintaining his lifestyle at the expense of creditors and was ordered to amend his budget to reflect his spouse's income.

In re Pharao, **2000 W.L. 1449846** (Bankr. E.D. Va. Sept. 11, 2000)

Even though Chapter 7 administration of the debtor's case was incomplete, debtor filed a Chapter 13 case, and plan was confirmed. Chapter 7 Trustee subsequently moved for a dismissal of Chapter 7 case on grounds that the debtor had "abandoned" the Chapter 7 case. The bankruptcy court denied the motion, because dismissal does not have the effect of vacating a debtor's discharge under Chapter 7. The Court was very clear that dismissal alone does not affect the discharge, but only eliminates the debtor's obligation to surrender non-exempt property to the Trustee. The Court concluded that the Trustee should either give creditors proper notice of intent to abandon assets or file an adversary proceeding to revoke the debtor's discharge.

In re Christiansen, **251 B.R. 69** (Bankr. W.D. Mo. 2000)

Chapter 7 Trustee moved to dismiss debtor's Chapter 7 petition for "cause" on the grounds that the debtor was not "truly needy," and continued to outspend his income, even post-petition. The Court denied the motion to dismiss on the grounds that the allegations were "far from enough to find 'cause for dismissal.'" The Court concluded that the debtor's bankruptcy filing "was brought about, at least in substantial part, by forces and events beyond the debtor's control, and was not the result of any serious or sinister misconduct by the debtor." The Court also concluded it was improper to consider a means test when considering dismissal under §707(a).

§722 – Redemption

In re Weathington, **254 B.R. 895**(6th Cir.B.A.P. 2000)

Debtor sought to execute right of redemption accorded by 11 U.S.C. §722 by paying liquidation value of automobile. Secured creditor relied on *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148(1997), and held out for replacement value. The Bankruptcy Court determined that because Chapter 7 was a liquidation case, a creditor's allowed secured claim should be determined by its liquidation value, i.e. "the amount that the creditor would receive if the creditor repossessed and sold the collateral most beneficial to the creditor."

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§726 – Distribution of Property of the Estate

***In re C.J. Milligan, Inc.*, 252 B.R. 465 (Bankr. E.D. Mo. 2000)**

The principal of the debtor moved the Bankruptcy Court to compel the I.R.S. to allocate the distribution it received on its secured claim from the Chapter 7 estate to trust fund tax obligations. The principal wanted the Court to either allocate the distribution from the debtor's estate pro rata between the trust fund and non-trust fund taxes owed or to earmark the distribution entirely to trust fund tax obligations. The I.R.S. maintained that because the payments were coming from a Chapter 7 bankruptcy estate the payments were considered involuntary, and not subject to a taxpayer's direction. The Bankruptcy Court ruled that no bankruptcy purpose would be served by ordering the I.R.S. to allocate any part of the distribution, and that §726(b) was not authority for pro rata distribution among the component liabilities that compromise the secured claim of the same entity.

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§727 – Discharge

***In re Keeney*, 227 F.3d 679 (6th Cir. 2000)**

The Court of Appeals affirmed lower court decision denying the debtor's discharge on the grounds that he concealed property interests and made a false oath. The debtor lived in a house that was purchased in his parents' name in 1983. The debtor never paid any rent to his parents for use of the property, and either the debtor or his business entity paid for improvements and made all the mortgage payments on the property. The debtor filed for bankruptcy in 1996. The Bankruptcy Court concluded that the debtor held a beneficial interest in the property, which he had continuously concealed, including within the one year before the date of the filing of the Petition, under §727(a)(2)(A), and that he had made "false oath" regarding his interest in the property in violation of §727(a)(4)(A).

***In re Strasnick*, 256 B.R. 330 (Bankr. M.D. Fla. 2000)**

The Bankruptcy Court denied discharge of a chief operating officer of a commercial bakery. The Court found that the assignee for benefit of the bakery's creditors was a proper plaintiff and a "creditor" under *11 U.S.C. §727(c)(1)*, and actions that the debtor had taken within the year prior to filing were done to hinder delay and defraud creditors. Bankruptcy Court granted the debtor's Motion to Dismiss for failure to state a claim on the grounds that the Complaint did not allege "knowing and fraudulent" conduct on the part of the debtor, or circumstantial facts tending to constitute such conduct. The Court also denied the debtor's Motion for Summary Judgment, and gave the Trustee leave to amend his Complaint.

***In re Sigust*, 255 B.R. 822 (W.D. La. 2000)**

A creditor objected to the discharge of husband and wife Chapter 7 debtors. The Bankruptcy Court agreed that the extensive omissions on the debtors' schedules, coupled with their continued failure to amend the schedules and the debtor's failure to maintain proper records despite advanced education, including the husband's MBA, warranted denial of discharge.

***In re Dolliver*, 255 B.R. 250**

Two years prior to filing their Chapter 7 petitions, the debtors transferred real estate to various family members. The husband and wife filed a joint voluntary Chapter 7 petition in August 1998, received their discharge on November 17, 1998, and their case was closed on November 20, 1998. Within the next year, the titleholders of the various parcels of real estate each transferred them back to the debtors for less than adequate consideration. A creditor moved to reopen the case, and filed a Complaint to revoke the debtors' discharge pursuant to §727(d). The debtors moved to dismiss the complaint on the grounds that it was filed more than one (1) year after their Chapter 7 case was closed. The plaintiff relied on case law, which arguably supported equitable tolling and the proposition that the case was never actually "closed" because the debtor had concealed assets. The Bankruptcy Court did not accept the plaintiff's arguments and dismissed the complaint. The Court noted that the plaintiff had other avenues of relief, including reopening the case to recover and administer fraudulently concealed assets, as well as criminal prosecution of the debtors. The Court noted that these were sufficient "avenues to vindicate creditors' interests and public policy….long after the chance to revoke a discharge is passed."

***In re Lipes*, 254 B.R. 501 (Bankr. S.D. Fla. 2000)**

Based upon debtor's failure to maintain and destruction of financial records, false oaths, and debtor's prolonged pattern of making hidden transfers to himself, family members and related entities, the Bankruptcy Court not only denied the debtor's discharge, but denied his Florida homestead exemption, because he acquired the exempt property with funds directly traceable to a creditor's collateral. The Court noted the debtor "used traceable proceeds from prior fraudulent transfers to acquire a homestead with the actual intent to hinder delay and defraud" a creditor.

***In re Dulock*, 250 B.R. 147 (Bankr. N.D. Ga. 2000)**

Former spouse filed complaint objecting to debtor's discharge. Debtor filed Motion for Summary Judgment. The Court reviewed the plaintiff's allegations regarding numerous transfers made by the debtor, and concluded that several did not constitute fraudulent transfers supporting denial and discharge. Issues of fact remained with respect to other transfers, and the Court granted the motion in part, and denied it in part.

***In re Lazenvy*, 253 B.R. 536 (Bankr. E.D. Ark. 2000)**

Bankruptcy Court did not allow party objecting to debtor's discharge to amend the complaint after the bar date for filing discharge complaints had passed when allegations arose out of transactions or events separate from those alleged in the original complaint.

Other recent cases denying discharge:

In re Baldridge, 256 B.R. 284 (Bankr. E.D.Ark. 2000)

In re Craig, 252 B.R. 822 (Bankr. S.D.Fla. 2000)

In re Perry, 252 B.R. 541 (Bankr. M.D.Fla. 2000)

In re Golob, 252 B.R. 69 (Bankr. E.D.Va. 2000)

In re Sethi, 250 B.R. 831 (Bankr. E.D.N.Y. 2000)

In re Stevens, 250 B.R. 750 (Bankr. M.D. Fla. 2000)

CHAPTER 13: INDIVIDUAL DEBT ADJUSTMENT

§ 1301 – The Co-Debtor Stay

In re Westberry, 215 F.3d 589 (6th Cir. 2000)

The Court evaluated whether federal income and self-employment taxes are consumer debt for purposes of the co-debtor stay of §1301. The debtor and his non-filing spouse owed $34,500 in joint income taxes, based upon the income generated by the debtor as a self-employed insurance salesman. The Debtor proposed to pay the taxes in full over 3 years. The IRS moved to levy against the non-filing spouse's income. The evidence indicated that all of the income had been used for familial support and that none of the money had been spent on the business.

The Court noted the differences in the way tax debts and the typical "consumer" debts are incurred. Consumer debt is incurred for personal/household purposes while taxes are incurred for a public purpose. Income taxes arise from earning money, not from consumption. Taxes do not arise out of an extension of credit and are not voluntary. The Court also pointed to the special status under the Bankruptcy Code given to taxes and held that tax debt did not qualify as consumer debt for purposes of the §1301 co-debtor stay.

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§§1306/1327 – The Vesting of Estate Property

Telfair v. First Union Mortgage Corporation, 216 F.3d 1333 (11th Cir. 2000)

After the Debtor received its discharge, FUMC applied post-petition mortgage payments to post-petition attorneys' fees incurred during the Chapter 13. The Debtor argued that this application of "estate property" constituted a violation of the discharge order and a violation of the automatic stay. The Court adopted the "estate transformation approach" in determining the estate's interest in the post-confirmation earnings of the Debtors and held that "only amounts required for plan payments remained property of the estate." The Court found that there had been no violation of the discharge or automatic stay provisions of the Bankruptcy Code.

In re Barbosa, 235 F.3d 31 (1st Cir. 2000)

After confirmation, but before the case was closed or converted, the Debtors moved to sell investment property. The fair market value of the property in 1997 was $64,000. The creditor secured by a lien on the investment property was owed approximately $114,000. Upon plan confirmation, the creditor was provided a secured claim of $64,000 and an unsecured claim of $50,000. The plan allowed for the pre-payment of the creditor's secured claim. It also provided that unsecured creditors would receive not less than 10%. The investment property was ultimately sold for $137,500. The Trustee argued that the excess proceeds should not be returned to the debtors but should be paid to the unsecured creditors.

The Court attempted to reconcile §1306, which defines property of the Chapter 13 bankruptcy estate, with §1327(b), which provides that "the confirmation of a plan vests all property of the estate in the debtor." Four different approaches to this reconciliation had been utilized by the courts. This court adopted the approach that "property of the estate at the time of confirmation vests in the debtors free of any claims from the creditors. The estate does not cease to exist however, and it continues to be funded by the Debtors' regular income and post-petition assets as specified in section 1306(a)." The Court cautioned that this approach must be counterbalanced with the rights to seek modification provided in §1329.

The Court then went on to determine whether §1329 would permit a modification of the Plan. The Debtors argued that there had been no substantial, unanticipated change of circumstances, and therefore, §1329 modification was unavailable. After acknowledging the line of cases supporting the Debtors' arguments for limiting modification to cases involving an unanticipated change in circumstances, the Court held that "the plain language of §1329 simply does not support a change in circumstances as a prerequisite to modification." The Court allowed the modification to the Plan in order to provide the excess proceeds to the unsecured creditors.

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§ 1322(b)(1) – Classification of Claims and Unfair Discrimination

In re Ramirez*,* 204 F.3d 595 (5th Cir. 2000)

The Chapter 13 Debtor owed a debt which had been co-signed by his sister. He proposed to pay the debt in full with 12% interest. The plan, which contemplated a 20% payment to unsecured creditors, would have required 33 payments before unsecured creditors would receive any distribution. The Debtor presented no evidence as to the fairness of the discrimination in favor of the co-signed debt.

The Court held that the "unfair discrimination" test of §1322 applies to co-signed debt. The Court reiterated the holding of *In re Chacon*, 202 F.3d 725 (5th Cir. 1999) that "[d]ifferences in treatment are not discriminatory if they rationally further a legitimate interest of the debtor and do not disproportionately benefit the cosigner . . .."

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§ 1322(b)(2) – Anti-Modification Provision

In re McDonald, 205 F.3d 606 (3rd Cir. 2000)

The Court held that the anti-modification provision of §1322(b)(2) did not apply to a wholly unsecured junior lien. It reasoned that "[t]he Supreme Court did not adopt the Fifth Circuit's view that §506(a) is inapplicable . . .. Once we accept that courts must apply § 506(a), then it follows, even under *Nobelman*, that a wholly unsecured mortgage holder does not have a secured claim. Justice Thomas specially said that the bank in *Nobelman* had a secured claim 'because' the bank's lien still attached to some existing value in the debtor's house. We do not think that there is any meaningful sense in which a court could be said to apply §506(a) if the sole function of the section was simply to adopt the state-law label of the claim as secured."

> ***See also In re Tanner***¸ 217 F.3d 1357 (11th Cir. 2000) and ***In re Bartee***, 212 F.3d 277 (5th Cir. 2000) for Circuit Court decisions agreeing with ***McDonald*** that the anti-modification provision of §1322(b)(2) does not apply to wholly unsecured junior mortgages.

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§ 1325 – Effects of Confirmation

In re Harvey, 213 F.3d 318 (7th Cir. 2000)

The Debtor filed a plan which proposed to pay cram down GMAC's $16,000 secured claim to $9,500, based upon the value of the vehicle. The plan was confirmed in November of 1996, without objection. A modified plan was filed in January of 1998. GMAC objected to the modified plan despite there having been no change in its treatment from the original confirmed plan. GMAC argued that due to certain ambiguities in the short form of the original plan with the long form of the original plan, both of which it had received, it was not bound by res judicata and could object to its treatment under the modified plan.

The Court determined that, in evaluating the provisions of the plan, it must apply the four corners principle that applies to federal consent decrees, rather than state law. The Court then held that GMAC had waived its arguments regarding ambiguity, due to its failure to object, because the ambiguity had been readily identifiable during the original confirmation hearings.

GMAC was thus bound by the provisions of the confirmed plan and could not object to its treatment under the modified plan.

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§ 1325(b)(2) – Reasonably Necessary

In re Awuku, 248 B.R. 21 (Bkrtcy. E.D.N.Y. 2000)

The Debtor was employed by the City of New York. Membership in and contribution to the retirement plan was mandatory for all employees. The Debtor voluntarily suspended the repayment of his pension plan loan but was not able to suspend his ongoing contributions. The Trustee objected to confirmation of the Chapter 13 on the basis that the Debtor was not contributing all of his disposable income since the pension contribution was not "reasonably necessary" for the support and maintenance of the debtor and the debtor's dependents.

The Court issued a lengthy opinion discussing whether "reasonably necessary" expenses must be limited to only present needs. The Court held that the pension contributions were reasonably necessary. It explained that the Debtor does not have to prove that he will be terminated in order for the Court to find the expenses reasonably necessary. If the Debtor would suffer materially adverse consequences, that would be enough to find the requisite necessity.

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§ 1325(b)(2) – Charitable Contributions

***In re Cavanagh*, **250 B.R. 107 (9th Cir. BAP 2000)

The Chapter 13 debtors' amended plan contained a newly-added expense item, totaling $234.00 per month, for charitable contribution to their church. This expense constituted less than 15% of the Debtors' monthly gross income and had commenced after the debtors' bankruptcy filing.

The Court evaluated the issue of "whether the bankruptcy court erred in finding that the charitable contribution was reasonably necessary for the maintenance and support of the Debtors and their dependents under §1325(b)(2)(A)." The Court concluded that "with the 1998 Act, Congress unequivocally established the priority of charitable contributions. The clear and unmistakable message is that the interests of creditors are subordinate to the interests of charitable organizations . . ." The Court determined that, based upon the clear and unambiguous statutory language of §1325(b)(2)(A), it would be improper to superimpose a "reasonableness" standard on top of the 15% limitation. "[A]nnual charitable contributions of to 15% of the debtor's gross income are deemed reasonably necessary for the maintenance and support of the debtor." However, the Court recognized that it would be appropriate to review the timing and any increased amount of tithing when considering the totality of the circumstances for the determination of whether the plan was filed in good faith, in compliance with §1325(a)(3).

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§ 1328 – Chapter 13 discharge

In re Cervantes, 219 F.3d 955 (9th Cir. 2000)

The mother of the debtor's child assigned to the County her accrued rights to support after applying for AFDC. The County obtained a judgment against the Debtor. The Debtor filed for relief under Chapter 13. The Court evaluated whether 42 U.S.C. §656(b), which states that "a debt . . . owed under state law to a state . . . or municipality . . . that is in the nature of support and that is enforceable under this part is not released by a discharge in bankruptcy," excepted the County's debt from discharge. The Court noted that §1328(a), which governs discharge under

Chapter 13, operated to discharge §523(a)(5) debts but not §523(a)(18) debts. The debt owed to the County fell under §523(a)(18). The Court acknowledged that there was moderate inconsistency between application of 11 U.S.C. §1328(a) and 42 U.S.C. §656(b) but that they were capable of co-existence. The Court held that §656(b) did operate to except the County's claim from discharge.

§ 1329 – Post-Confirmation Modification of Plans

In re Nolan, 232 F.3d 528 (6th Cir. 2000)

The Debtor filed Chapter 13. The creditor, secured by a vehicle, filed a proof of claim in the amount of $12,300. The car was ultimately valued at $8,200.00 for purposes of determining the amount of the creditor's secured claim to be paid under the plan. Approximately one year after confirmation, the Debtor filed a motion to surrender the vehicle, to reclassify the claim from secured to unsecured and for authority to incur credit for a different car. The evidence reflected that the debtor had placed approximately 100,000 miles on the vehicle in three years and that it was no longer dependable.

The Court determined whether the debtor can modify her plan post-confirmation to surrender a vehicle and reclassify the debt from secured to unsecured. The Court reviewed the requirements of §1329 which governs plan modification and the *In re Jock*, 95 B.R. 75 (Bkrtcy. M.D.Tenn. 1989) decision which set out three additional requirements to be satisfied in order for a debtor to reclassify secured debtor to unsecured. The Court held that "§1329(a) only permits modification of the amount and timing of payments, not the total amount of the claim," even for a claim only partially secured by collateral. The Court based its decision on 5 factors: 1) "section 1329(a) does not expressly allow the debtor to alter, reduce or reclassify a previously allowed secured claim;" 2) "the proposed modification would violate section 1325(a)(5)(B), which mandates that a secured claim is fixed in amount and status and must be paid in full once it has been allowed;" 3) "the proposed modification would contravene section 1327(b), because a contrary interpretation postulates an unlikely congressional intent to give debtors the option to shift the burden of depreciation to a secured creditor . . . ;" 4) "only the debtor, trustee, and holders of unsecured claims are permitted to bring a motion to modify a plan pursuant to section 1329(a)." The same standing is not provided to the secured creditor for a situation where the collateral appreciates; and 5) "*Jock's* interpretation is at odds with the plain language of section 1329."

In re Cruz, 253 B.R. 638 (Bkrtcy. D.N.J. 2000)

The Debtors owned real property, which they valued on their schedules at $40,000. They proposed to pay through the plan the arrearage on their first mortgage and the total amount of the second mortgage. The plan was confirmed. The Third Circuit then issued its opinion in *McDonald* (discussed in these materials) which acknowledged the inapplicability of the anti-modification provisions of §1322(b)(2) to wholly unsecured junior mortgages. After having made 22 plan payments, the Debtors' filed a motion to modify their plan, based on the *McDonald* decision, to strip off the second mortgage, in light of the amount of the first mortgage and the value of the real property.

The Court held that the Debtors were bound by the confirmed plan and that the value of the real property was fixed upon plan confirmation. Res judicata prevented the re-litigation of issues which were or could have been brought as part of the original confirmation process. The Court refused to allow the Debtor's to modify their plan under §1329 because there was no specific provision in that section allowing a debtor to reclassify a secured claim to an unsecured claim or to change the amount of the claim. The Court held that *McDonald* is not subject to retroactive application despite the fact that the bankruptcy courts in the district were reversed by the decision.

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§ 1330 – Revocation of Confirmation

In re Nikoloutsos, 199 F.3d 233 (5th Cir. 2000)

The Court evaluated whether the ex-wife of the debtor had timely filed a proof of claim upon which it could find that confirmation should be revoked. The unique facts of this case present a situation where the debtor owed the ex-wife in excess of $863,000 based upon a state court judgment rendered 3 days before his Chapter 7 filing. The Debtor scheduled the debt as $0.00. The bankruptcy judge was aware of the judgment when it granted relief from stay in the early stages of the Chapter 7 to allow the ex-wife to have the state court determine the amount of punitive damages. The debtor converted to Chapter 13. The ex-wife appeared to contest each step of the Debtor's journey through Chapter 13 but did not follow the technical requirements of timely filing a proof of claim.

The Circuit Court held that the filing of an adversary proceeding and the other appearances by the ex-wife, in the Chapter 13, constituted the timely but informal filing of a proof of claim. The Court applied the five-part test of *Reliance Equities, Inc.*, 966 F.2d 1338, 1345 (10th Cir. 1992) which focuses on the provision of notice to the debtor and the estate and the equities of allowing the claim in allowing the claim. The Court then found that conversion to Chapter 13 had been in error, because of the Debtor's ineligibility under §109(e) and that confirmation should be revoked due to the knowing and fraudulent conduct of the Debtor.

<u>"Chapter 20's"</u>

In re Young, 2001 WL 37709 (10th Cir. 2001)

The issue in this case was whether a debtor can convert to Chapter 13, after receiving a Chapter 7 discharge. The Debtor owed $300,000 in punitive damages to a creditor, which constituted a non-dischargeable debt under Chapter 7. The Debtor converted to Chapter 13, after receiving his discharge, when the creditor filed a dischargeability complaint, but before the dischargeability complaint had been adjudicated. The creditor objected to confirmation. The Debtor ultimately proposed a 60-month plan in Chapter 13.

The Court held that due to the increased scrutiny of the Chapter 13 plan which results after a conversion from Chapter 7, the "Chapter 20" presented by this situation was proper. The Court acknowledged that a good faith determination was to be made on a case-by-case basis, based upon the totality of the circumstances. After applying the facts to the 11 factors of *Flygare v. Boulder*, 709 F.2d 1344, 1347-48 (10th Cir. 1983), the Court held the plan was proposed in good faith.