

## Midwestern Bankruptcy Institute

## **Case Law Updates**

Hon. Shon K. Hastings

U.S. Bankruptcy Court (D. N.D.) | Fargo

Hon. Dale L. Somers

U.S. Bankruptcy Court (D. Kan.) | Topeka

Hon. Brian C. Walsh

U.S. Bankruptcy Court (E.D. Mo.) | St. Louis

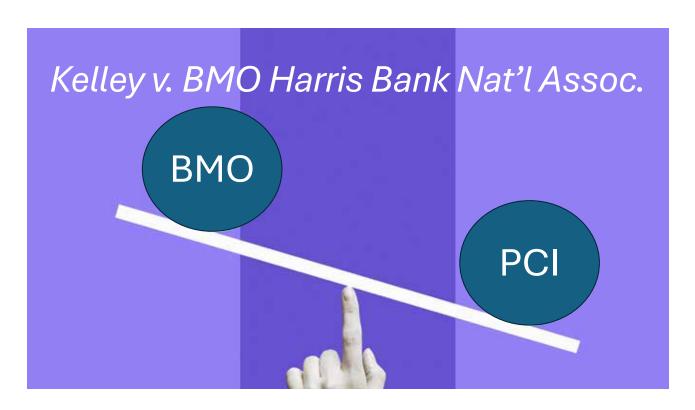






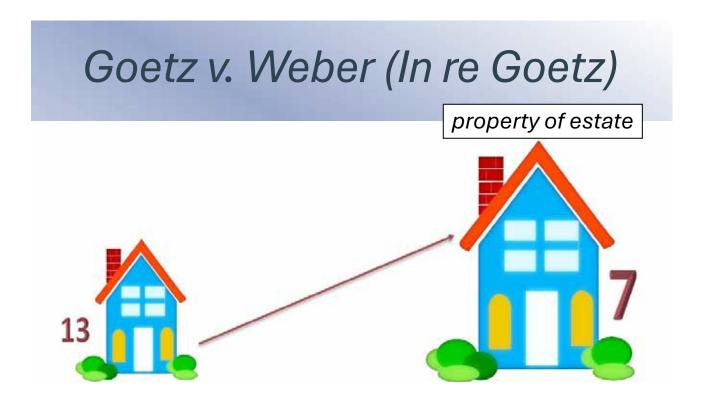


Kelley v. BMO Harris Bank Nat'l Assoc.

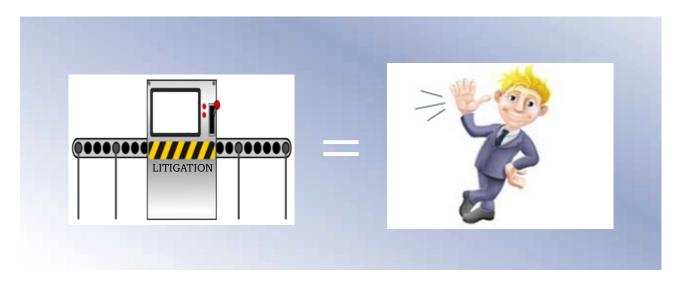








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Sec. Nat'l Bank v. Vera T. Welte Testamentary Tr. (In re Vera T. Welte Testamentary Tr.)



# TENTH CIRCUIT HON. DALE L. SOMERS United States Bankruptcy Appellate Panel for the Tenth Circuit United States Bankruptcy Court for the District of Kansas, Chief Judge

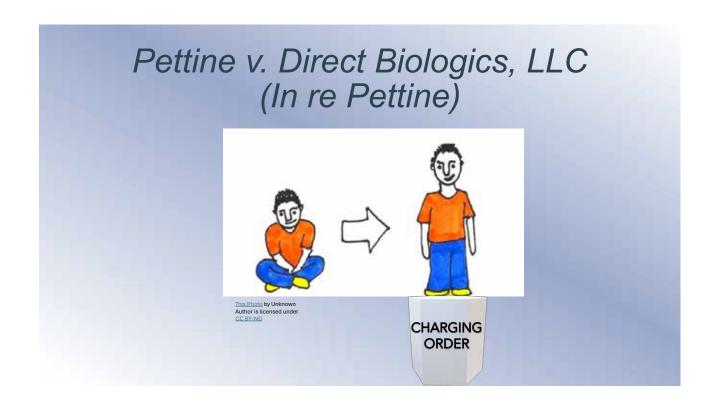


# Grange Ins. Assoc. v. Woods (In re Woods)

justifiable reliance required if false representation at issue







# Gould v. Falcon Strategic Partners IV (In re Integrity Directional Servs. LLC)



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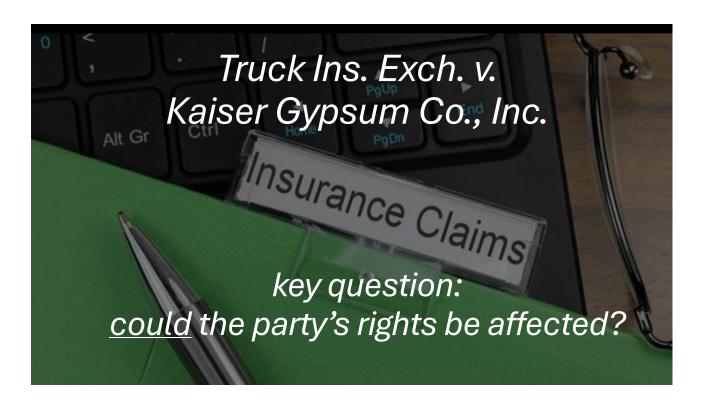
# SUPREME COURT

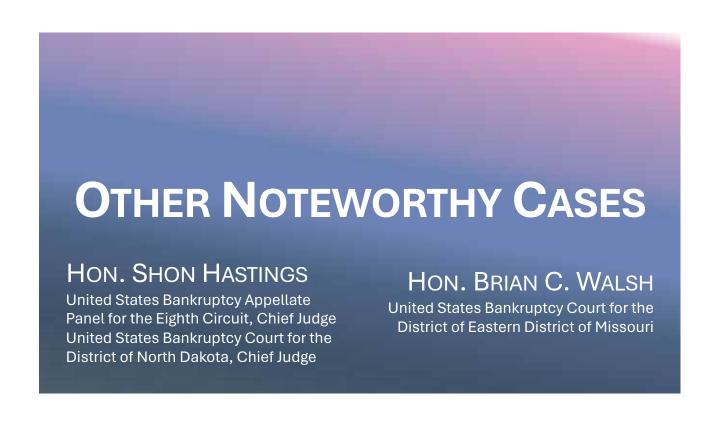
Hon. Brian C. Walsh

United States Bankruptcy Court for the District of Eastern District of Missouri









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Unsecured Creditors of
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Inc. v. Charter Comms.
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(In re Windstream
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5TH CIRCUIT: § 523(a) APPLIES TO CORPORATE SUBCHAPTER V DEBTORS

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Ivanov v. Van's Aircraft, Inc.
(In re Van's Aircraft, Inc.)

BANKR. D. OR.:

IF PLAN IS NON-CONSENSUAL,

§ 523(a) APPLIES TO CORPORATE
SUBCHAPTER V DEBTORS



# Licup v. Jefferson Ave. Temecula, LLC (In re Licup)



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In re Florist Atlanta, Inc.



In re M.V.J. Auto World, Inc.





# Case Law Update October 2023 through September 2024

Midwestern Bankruptcy Institute

presented by the

American Bankruptcy Institute

and the

University of Missouri-Kansas City

Hon. Brian T. Fenimore
U.S. Bankruptcy Court for the
Western District of Missouri, Chief
Judge

Hon. Shon Hastings
U.S. Bankruptcy Appellate Panel
for the Eighth Circuit, Chief Judge
and U.S. Bankruptcy Court for the
District of North Dakota, Chief Judge

Hon. Dale L. Somers

U.S. Bankruptcy Appellate Panel for the Tenth Circuit and U.S. Bankruptcy Court for the District of Kansas, Chief Judge

Hon. Brian C. Walsh
U.S. Bankruptcy Court for the
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#### I. Supreme Court

A. Nonconsensual Third-Party Releases Are Not Permissible in a Chapter 11 Plan. *Harrington v. Purdue Pharma L.P.*, 144 S. Ct. 2071 (2024) (Gorsuch, J.).

Debtor Purdue Pharma, operated and controlled primarily by members of the Sackler family, manufactured and distributed pharmaceutical opioids. Purdue Pharma advertised its OxyContin product as less addictive than other pain medications. When that turned out to be incorrect and thousands of people overdosed, the debtor and the Sacklers faced significant tort liability. In response, the Sacklers began a campaign to drain the debtor of its assets. Over the course of almost a decade, the debtor made significant distributions to the Sacklers, who then moved these funds into protected trusts overseas.

The Sacklers then placed the debtor in chapter 11 bankruptcy. To resolve the growing litigation against the debtor, they offered to place a portion of the funds they extracted from the company into a trust for the settlement of any opioid-related claims. However, in return, the Sacklers sought a provision in the debtor's plan releasing them from liability for all present and future opioid claims. Furthermore, the release extended to claimants, including those who neither participated in the plan nor consented to the release. The bankruptcy court approved the plan, but the matter was appealed all the way to the Supreme Court.

Justice Gorsuch wrote the opinion for a narrow majority. The Court first turned to the language of § 1123(b) governing what is permissible, but not mandatory, in a chapter 11 plan of reorganization. Nothing in § 1123(b) grants express authority for a court to confirm a plan involving nonconsensual third-party releases. Although subsection (b)(6) provides that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title," the Court categorized this as a "catchall" phrase. Under the *ejusdem generis* canon of construction, the phrase must be limited by its surrounding language and context. And because subsections (b)(1)–(5) permit a court to adjust claims concerning the relationship between the debtor and its creditors, subsection (b)(6) should not be read to permit a court to adjust claims as to *nondebtors*, like the Sacklers.

According to the majority, this interpretation aligns with the overall framework of chapter 11 bankruptcies. Through nonconsensual third-party releases, the Sacklers effectively sought the same benefits of a discharge injunction, without subjecting themselves to the burdens of filing bankruptcy personally, such as making robust disclosures and putting their assets on the line. Furthermore, because Congress expressly permitted third-party releases in the context of asbestos litigation, Congress's failure to do so within § 1123(b)(6) is significant.

Justice Kavanaugh wrote the dissent. Taking a pragmatic approach, he first described how commonplace nonconsensual third-party releases had become in mass tort bankruptcies. These releases are beneficial, as they resolve collective-action problems and the "race to the courthouse" by multiple creditors. Given this context, the dissent would find that a provision in a plan providing for third-party releases is "appropriate" and not inconsistent with the Code under § 1123(b)(6). Furthermore, the dissenters read § 1123(b)(6) as granting courts discretion to approve nonconsensual third-party releases where they increase the recovery for claimants and achieve an equitable result. According to the dissenters, the opioid claimants' ability to recover anything was nearly impossible without these third-party releases, making them necessary and appropriate.

# B. "Prospective Parity" Is the Remedy for Non-Uniform Quarterly Chapter 11 Fees. *United States Tr. v. John Q. Hammons Fall 2006*, *LLC*, 144 S. Ct. 1588 (2024) (Jackson, J.).

In Siegel v. Fitzgerald, 596 U.S. 464 (2022), the Supreme Court held that the statute permitting higher fees for chapter 11 debtors in districts with U.S. Trustees, as opposed to those with Bankruptcy Administrators, violated the Bankruptcy Clause's uniformity requirement and was unconstitutional. This case focused on the appropriate remedy for that constitutional violation. Noting Congress's desire to have the U.S. Trustee program entirely funded by user fees, the disruption that would occur were refunds offered to applicable debtors in U.S. Trustee districts, and the lack of any clear indication from Congress that Bankruptcy Administrator fees should be increased, the Court determined "prospective parity" was the appropriate remedy here.

This specific issue is unlikely to be encountered again, as Congress replaced the permissive "may" in the fee statute with a mandatory "shall," resulting in equal fees for U.S. Trustee and Bankruptcy Administrator districts as of April 2021.

### C. Insurers Are "Parties in Interest" that May Object to a Plan. Truck Ins. Exch. v. Kaiser Gypsum Co., Inc., 144 S. Ct. 1414 (2024) (Sotomayor, J.).

After facing significant liability related to claims involving asbestos exposure from its products, the debtor filed for chapter 11 bankruptcy. The debtor's insurer was required to defend against certain asbestos claims arising within certain coverage dates. The debtor's reorganization plan channeled claims not covered under the insurance policy into a trust, requiring claimants to comply with certain disclosure and documentation requirements to prevent fraudulent or duplicative claims. Conversely, claims covered under the policy were not channeled into the trust but brought directly against the debtor in the tort system. The insurer objected to the

plan, arguing that the differing treatment of insured versus non-insured claims subjected it to increased liability for fraudulent or duplicate claims.

On reviewing the objection, the bankruptcy court applied the "insurance neutrality" doctrine. This doctrine, applied by various lower courts, grants an insurer standing only where a plan increases its pre-petition obligations or impairs its pre-petition rights. Because the plan here did neither, the bankruptcy court concluded that the insurer lacked standing to object to the plan.

On appeal, the key question before the Supreme Court was one of statutory interpretation: does the reference in § 1109(b) to a "party in interest" include an insurer? Writing for a unanimous court, Justice Sotomayor concluded that it does. Turning to the language of the statute and the express list of parties permitted to raise any issues before the court, she reasoned that the purpose behind § 1109(b) is to permit parties that have a direct financial stake in the outcome an opportunity to be heard. The Court also observed Congress' historical trend of expanding the group of parties that may participate in a bankruptcy case, including § 1109(b)'s addition of a "party in interest." Given this context, the Court concluded that insurers "with financial responsibility for bankruptcy claims are parties in interest." Indeed, an insurer can be affected by a bankruptcy plan in numerous ways.

Finally, the Court expressly rejected the "insurance neutrality" doctrine applied by the bankruptcy court below. Section 1109(b) is meant to ask "whether the reorganization proceedings might affect a prospective party, not how a particular reorganization plan actually affects that party." In short, the doctrine focused too much on pre-petition rights, and not the various ways in which an insurer's postpetition rights may be affected under a plan.

D. Supreme Court Accepts Certiorari to Determine Whether § 106(a)(1) Abrogates Sovereign Immunity in Avoidance Actions Brought Under § 544(b). *Miller v. United States*, 71 F.4th 1247 (10th Cir. 2023) (Baldock, J.), cert. granted, 144 S. Ct. 2678 (2024).

The chapter 7 trustee brought an avoidance action under § 544(b), seeking to avoid personal tax debt payments the debtor made to the IRS. The Utah cause of action the trustee invoked under § 544(b) required that an "actual creditor" have an unsecured claim arising before the transfers. The IRS argued the trustee could not succeed because, outside of bankruptcy, an actual creditor's suit against the IRS would be barred by sovereign immunity. The chapter 7 trustee argued that the waiver of sovereign immunity in § 106(a) abrogated sovereign immunity not only as to the trustee's § 544(b)(1) adversary proceeding against the IRS, but also as to the underlying Utah state law cause of action he invoked to avoid the transfers.

The Tenth Circuit affirmed the decision of the bankruptcy court that § 106(a) waives sovereign immunity as to state law avoidance actions a trustee asserts under § 544(b)(1). The Tenth Circuit reviewed the text of § 106(a) and concluded "the critical phrase 'with respect to' in § 106(a)(1) clearly expresses Congress's intent to abolish the Government's sovereign immunity in an avoidance proceeding arising under § 544(b)(1), regardless of the context in which the defense arises." The Tenth Circuit also examined § 106(a)(2) and determined "the authority which subsection (a)(2) plainly confers would be substantially curtailed if Congress had intended an assertion of sovereign immunity to preclude a bankruptcy court from considering whether a trustee has satisfied the substantive elements of an underlying state law cause of action invoked pursuant to § 544(b)(1)." The Tenth Circuit concluded § 106(a) waived the IRS's sovereign immunity both as to the chapter 7 trustee's proceeding under § 544(b)(1) and the underlying Utah state law.

The Supreme Court subsequently accepted certiorari to resolve the dispute.

#### II. Eighth Circuit

A. Post-Petition, Pre-Conversion Increase in Home Value is Property of the Converted Chapter 7 Bankruptcy Estate. *Goetz v. Weber (In re Goetz)*, 95 F.4th 584 (8th Cir. 2024) (petition for cert. filed June 10, 2024) (Shepherd, J.).

Agreeing with the Ninth Circuit's *In re Castleman*, 75 F.4th 1052 (9th Cir. 2023), the Eighth Circuit affirmed the BAP and the bankruptcy court, holding that under the plain text of §§ 348(f)(1)(A) and 541, a post-petition, pre-conversion increase in the value of the debtor's home is property of the converted chapter 7 estate.

Between the time the debtor petitioned under chapter 13 in August 2020 and when she converted to a case under chapter 7 in April 2022, the value of her home increased by approximately \$75,000. Although there was insufficient equity to justify liquidation in August 2020, by April 2022, roughly \$62,000 remained available for the benefit of the estate after deducting the secured lien, the \$15,000 applicable Missouri homestead exemption, and anticipated costs of sale. The debtor moved to compel the chapter 7 trustee to abandon the property under § 554, arguing that, as of the date of the filing, the property was of inconsequential value and benefit to the estate.

The bankruptcy court concluded that, under the plain text of § 348(f), the equity in the debtor's residence was property of her converted estate because she owned it on the petition date and still owned and retained it on the conversion date. The bankruptcy court explained that post-petition increases in equity are inseparable from the home; consequently, both are property of the estate.

The Eighth Circuit BAP affirmed. It ruled that the plain language of §§ 348(f) and 541 provide that prepetition property owned as of the chapter 13 petition date, together with increases in equity, remained property of the bankruptcy estate upon conversion; new property the debtor acquired post-petition was not property of the converted estate unless the debtor converted in bad faith. The BAP also rejected the debtor's second argument that because of vesting upon confirmation or exemption the home was "removed" from the estate. It ruled that § 1327 regarding vesting does not apply in chapter 7, and the debtor's \$15,000 exemption claim only removed \$15,000 from the estate, not the entire residence.

On appeal, the Eighth Circuit affirmed. The Eighth Circuit viewed the increased equity as proceeds from property of the estate (the residence). residence remained in the debtor's possession or under her control on the conversion date, the post-petition pre-conversion increase in equity was property of the converted bankruptcy estate. Although the property vested in the debtor upon confirmation of her chapter 13 plan, the provisions of chapter 13 no longer applied once the debtor converted to chapter 7. As to the assertion that the debtor exempted the entire interest in the property under the "snapshot" concept, the court rejected the suggestion that the Missouri exemption statute granted an in-kind exemption and ruled that the "complete snapshot rule" had no bearing on whether the postpetition, pre-conversion increase in equity in the debtor's residence was property of the converted estate. The court did not address the debtor's argument based on the legislative history of § 348(f)(1) because the plain text of the statute is unambiguous. Finally, despite characterizing the equity as proceeds, the Eighth Circuit rejected the debtor's argument that its rationale conflicted with the Tenth Circuit's decision in Rodriguez v. Barrera (In re Barrera), 22 F.4th 1217 (10th Cir. 2022), in which the Tenth Circuit concluded that proceeds from the post-petition, pre-conversion sale of a residence would not become property of the converted estate under § 348(f)(1) because the proceeds were separate property that arose after the petition date but before conversion. As the Eighth Circuit explained, the Tenth Circuit's decision was distinguishable: "There, the question was 'whether, in a postconfirmation conversion from Chapter 13 to Chapter 7, proceeds from the postpetition sale of property are identical to the underlying property that the debtor possessed on the Chapter 13 petition date."

B. Judicial Estoppel Barred Chapter 13 Debtor from Pursuing a Post-Confirmation Undisclosed Personal Injury Claim that Occurred Before Plan Payment Completion. *Hughes v. Canadian Nat'l Ry. Co.*, 105 F.4th 1060 (8th Cir. 2024) (Melloy, J.).

The debtor, who was injured post-confirmation in two separate work accidents, had standing to pursue undisclosed claims against his employer and others because the estate vested in the debtor under § 1327. The Eighth Circuit ruled that § 1327, the

more specific provision, controls the more general § 554(d), which provides that undisclosed estate assets that are not expressly abandoned remain property of the estate. But the debtor was judicially estopped from asserting a claim for the first injury that occurred six months before he completed his plan payments because his "knowing" failure to disclose the claim was tantamount to denying the claim's existence, which was inconsistent with his later assertion of the claim. The debtor was not judicially estopped, however, from asserting a claim for the second injury that occurred after the debtor completed his five-year plan.

C. Eighth Circuit Lacked Jurisdiction Where a District Court Order Remanding a Case to the Bankruptcy Court Was Not Final. Sec. Nat'l Bank v. Vera T. Welte Testamentary Tr. (In re Vera T. Welte Testamentary Tr.), 96 F.4th 1034 (8th Cir. 2024) (Shepherd, J.); In re Vera T. Welte Testamentary Trust, 73 Bankr. Ct. Dec. 157 (Bankr. N.D. Iowa 2024).

In this chapter 12 case, the Vera T. Welte Testamentary Trust contested the enforceability of dragnet clauses within mortgages used to secure loans funding trust beneficiary, Frank Welte's, farming operations. A creditor asserted the clauses were enforceable, filed a proof of claim against the bankruptcy estate, and moved to dismiss the debtor's case for ineligibility. The parties litigated the dragnet clause enforceability issue in both Iowa state court and the bankruptcy court, but the two courts reached conflicting decisions. Following an appeal from the bankruptcy court, which held the creditor lacked standing and could not assert its proof of claim against the estate because the clauses were unenforceable, the district court remanded, giving preclusive effect to the judgment of the Iowa Court of Appeals that the clauses were enforceable. The trust appealed the district court's order, and the estate cross appealed.

The Eighth Circuit concluded that the district court order remanding a case to the bankruptcy court was not final because the remand to the bankruptcy court anticipated further judicial activity. Specifically, the bankruptcy court must apply the district court's conclusion that the Iowa Court of Appeals' decision had preclusive effect with respect to the dragnet clauses and the sums owed under the promissory notes. The court commented that this application will "almost certainly" require the bankruptcy court to address the creditor's motion to dismiss, in which the creditor alleged that the debtor was not an eligible debtor under chapter 12 because it was not a business trust. Accordingly, the Eighth Circuit concluded that it lacked jurisdiction over the appeal and cross-appeal and dismissed both.

On remand, Judge Collins granted the creditor's motion to dismiss, concluding the trust is not eligible to be a chapter 12 debtor. The court explained that to be eligible, the trust would need to satisfy the Code's definition of corporation, which includes

"a business trust, but no other kinds of trust." The trust lacked key features of a business trust: it was not created for a business purpose but was established as a land trust to preserve the farmland. It also lacked the requisite "continuity uninterrupted by death among beneficial owners," because it would terminate at Frank Welte's death. Finally, it lacked transferability of interests because its beneficiaries could not freely transfer their trust interests. Because the trust was not a business trust, the court dismissed the debtor's chapter 12 case.

D. Two of Three Waiver Elements Survive Supreme Court's Morgan v. Sundance, Inc. Decision. Thomas v. Pawn America, Minn., LLC (In re Pawn America Consumer Data Breach Litig.), 108 F.4th 610 (8th Cir. 2024) (Stras, J.).

After defendants "spent months litigating in federal court," including by "participat[ing] in an hour-long motion-to-dismiss hearing, stipulate[ing] to a discovery plan, and schedul[ing] a mediation," they asked the district court to compel arbitration. The district court determined the defendants had waived their contractual right to arbitration.

The Eighth Circuit affirmed. The Eighth Circuit historically employed a three-part test to determine whether to grant a motion to compel arbitration ("whether the party seeking arbitration (1) knew of the right; (2) acted inconsistently with it; and (3) 'prejudice[d] the other party [with its] inconsistent acts"). But the Supreme Court's decision in *Morgan v. Sundance, Inc.*, 596 U.S. 411 (2022), "ma[de] clear that [courts] can no longer consider prejudice." The Eighth Circuit then determined that *Morgan* was "no reason to strip our test down to the stude and start over." Instead, the Eighth Circuit's "three-part test now has two parts": "whether [the party seeking arbitration] (1) knew of its 'existing right' and (2) acted 'inconsistently with' it." "[O]ne way to act inconsistently with it is to 'substantially invok[e] the litigation machinery rather than promptly seek[] arbitration"—something the defendants had done here. Because the defendants substantially invoked the litigation machinery in district court, they waived their right to arbitration.

E. Even if Case Is Dismissed Under § 305, Creditors May Face Consequences for Using Bankruptcy as a Collection Device. Stursberg v. Morrison Sund PLLC, 112 F.4th 556 (8th Cir. 2024) (Loken, J.).

Soon after a creditor warned that it would "commence collection steps" for nonpayment, the creditor filed an involuntary petition against the debtor. The bankruptcy court dismissed the involuntary petition by abstaining under § 305. Months later, when the debtor asked the bankruptcy court to award fees and costs for a wrongful involuntary petition under § 303(i)(1), the bankruptcy court denied

the debtor's motion, concluding the debtor's request was untimely and that dismissal under § 305 precludes damages under § 303(i), among other things. The debtor did not appeal that determination. In the interim, the debtor had commenced litigation outside of bankruptcy court seeking damages for the involuntary petition under state law theories of abuse of process and wrongful use of civil proceedings. The district court dismissed that litigation, concluding a bankruptcy court's purportedly exclusive authority to adjudicate damages claims for filing an involuntary petition in bad faith conflict preempted the state law claims.

The Eighth Circuit affirmed the district court's dismissal but premised its affirmance on a theory the district court did not analyze. Specifically, the Eighth Circuit concluded that the bankruptcy court's unappealed order denying the debtor's request for damages under § 303(i)(1)—in which the bankruptcy court determined that the debtor could not recover attorneys' fees and costs under § 303(i)(1) because § 305 precludes damages under § 303(i)—further precluded the district court from subsequently awarding damages for bad faith under § 303(i)(2). As the Eighth Circuit explained, the debtor's failure to appeal the bankruptcy court's final order was fatal and required dismissal of the district court case.

The Eighth Circuit further explained that the bankruptcy court's unappealed, preclusive final order was itself incorrect—the bankruptcy court erred in concluding that § 305 dismissal precludes damages under § 303(i). Instead, "§ 303(i)(2) damages are allowed when an involuntary petition is dismissed under § 305(a)(1)." As the Eighth Circuit explained, § 303(i) provides that, "[i]f the court dismisses a petition under this section other than on consent of all petitioners and the debtor," the court may award the debtor damages "against the petitioner that filed the petition in bad faith." Rejecting the creditor's argument that this language made damages only available to a debtor if the dismissal was "under this section" (i.e. dismissal under § 303), the court concluded that the phrase "under this section" referred to the closest antecedent "petition"—making damages available under § 303(i) whenever the court dismissed a case filed against an involuntary debtor under § 303, even if the case was dismissed under § 305. Moreover, "Congress intended that the federal court that dismisses an involuntary case has exclusive jurisdiction to enforce the debtor remedies provided in § 303," the availability of dismissal under § 305 did not preclude an award of damages under § 303 that is premised on state law principles because federal courts can award remedies that mirror those under state law. A contrary reading would be problematic because "§ 305 confers no remedial authority," and it would be impermissible for the mere availability of dismissal under § 305 to "preempt' many § 303(i)(2) damages claims that a federal court looking to state law should allow." Nonetheless, because the debtor had not appealed the bankruptcy court's erroneous decision that damages

were unavailable under § 303(i), the district court ultimately did not err in dismissing the case.

In his concurrence, Chief Judge Colloton explained that he would have affirmed the dismissal on pre-emption grounds alone.

F. In Pari Delicto Defense May Apply to Prevent a Trustee from Asserting Claims Against Parties that Participated in Debtor's Ponzi Scheme. Kelley v. BMO Harris Bank Nat'l Assoc., No. 23-2551, No. 23-2632, 2024 WL 4158179 (8th Cir. Sept. 12, 2024) (Colloton, C.J.).

Pre-petition, plaintiff Kelley was appointed receiver of the Petters Company, Inc., an entity created to perpetrate a multi-billion-dollar Ponzi scheme. As receiver, Kelley filed a chapter 11 petition of behalf of the Petters Company and subsequently was appointed chapter 11 trustee. Now receiver-turned-trustee, Kelley brought an adversary proceeding against BMO Harris Bank under several theories, including that BMO's predecessor-in-interest aided and abetted the Petters Company's breach of fiduciary duty. The bankruptcy court and district court concluded the *in pari delicto* defense (an equitable principle that bars recovery for a wrong the plaintiff participated in) was unavailable to BMO because the Petters Company (which had been formed to perpetrate the wrongdoing) had been transformed into a receivership entity, and, therefore, "was no longer bound by its officers' previous fraudulent acts." A jury ultimately awarded Kelley more than \$500 million in damages against BMO.

On appeal, the Eighth Circuit concluded BMO had been entitled to prevail on its in pari delicto defense. The court explained that the defense is "available in an action by a bankruptcy trustee against another party if the defense could have been raised against the debtor" because "[a] trustee in bankruptcy stands in the shoes of the debtor." Though Kelley would have been "unconstrained by the fraudulent acts of [the Petters Company's] officers" (and therefore, arguably not subject to the defense) under Minnesota law while the case remained in receivership, "Kelly [was] acting in this case as a bankruptcy trustee, not as a receiver." The intervening receivership did not "cleanse" Petters Company of any wrongdoing or "extinguish" the defense. And once the Petters Company entered bankruptcy, "Kelley-as-receiver no longer controlled [the company's] assets and thus had no claims to bring." Instead, "the claims entered the bankruptcy estate subject to [the in pari delicto] defense based on [the Petters Company's] previous fraudulent acts." Concluding that the defense barred Kelley's claim, the Eighth Circuit reversed. Remand, however, was "unnecessary." Because the Petters Company "was created solely to operate the Ponzi scheme," "the defense of in pari delicto . . . barre[d] Kelley's claims on behalf of [the Petters Company]" and any contrary result "would be an abuse of discretion."

G. Eighth Circuit BAP Dismisses Appeal as Equitably Moot. *Davies v. Daugherty (In re Davies)*, 651 B.R. 445 (B.A.P. 8th Cir. 2023) (Ridgway, J.).

The debtor filed a motion to impose the stay in a chapter 13 case in which the stay did not go into effect due to debtor's recent history of bankruptcy filings. The bankruptcy court denied the motion. The debtor appealed, but the case was dismissed while the appeal was pending. The BAP explained that an appeal is constitutionally moot when there is no longer a case or controversy, allowing the appellate court to give effective relief. The panel determined that the dismissal of the bankruptcy case rendered the appeal constitutionally moot and dismissed the appeal for lack of jurisdiction.

H. Post-Petition Domestic Support Claim in a Chapter 7 Two-Conversion Case Satisfied § 348(d), Requiring the Bankruptcy Court to Treat the Claim as if it Arose Prepetition for Purposes of Determining its Priority. LaMonda v. Harder (In re LaMonda), 656 B.R. 494 (B.A.P. 8th Cir. 2024) (Hastings, C.J.).

The debtor petitioned for relief under chapter 7 in August 2019. In November 2019, the debtor and his former spouse divorced, and the state court ordered the debtor to pay \$2,000 per month in child support. A few weeks later, the debtor converted to a case under chapter 13. The case remained in chapter 13 for three years before the bankruptcy court converted it back to chapter 7. The former spouse filed a claim in the reconverted chapter 7 for \$80,000 in missed child support payments. The trustee objected to the claim, arguing that claims for post-petition domestic support must be disallowed under § 502(b)(5) and any purported lien was post-petition and unenforceable. The bankruptcy court sustained the objection and disallowed the claim.

The BAP reversed, holding that although the claim arose after the chapter 7 filing, it met the requirements under § 348(d), which provides that a claim arising after the order for relief and before conversion under section 1307 shall be treated as a prepetition claim. The BAP concluded that § 348(d) "does not limit the benefit of prepetition treatment to claims arising in a reorganization chapter. It also does not distinguish between one-conversion and two-conversion cases. Section 348 simply outlines the applicable time period: the claim against the estate or the debtor must arise after the order for relief but before conversion in a case that is converted under section 1112, 1208, or 1307 to be eligible to be treated as a prepetition claim."

The BAP remanded the case to the bankruptcy court for further proceedings.

I. Debtor's Guarantee of Mother's Student Loans Dischargeable as Imposing an Undue Hardship. *North Dakota v. Haugen*, 657 B.R. 861 (D.N.D. 2024) (Hovland, J.).

In 2007, the debtor cosigned her mother's student loans to North Dakota. The mother later defaulted, and North Dakota sued the debtor and her mother. By the time the debtor filed her chapter 7 petition, the debtor was 40-years old, had three children including one of daycare age, was married to a wage earner, was in good health, and was employed full time earning between approximately \$13.13 and \$14.73 per hour. The nature of the debtor's job enabled her to share a car with her husband and avoid daycare expenses. The debtor had not made any payments toward her mother's loans, she was not eligible for any income-based repayment plan or deferment, and her monthly payments to North Dakota would have been \$450 per month. The debtor filed an adversary complaint in bankruptcy seeking discharge of her debt to North Dakota as imposing an undue hardship. The bankruptcy court determined the North Dakota loans were dischargeable.

The district court affirmed. Under the Eighth Circuit's totality of the circumstances test, the court considered "(1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the reasonable living expenses of the debtor and her dependents; and (3) any other relevant facts and circumstances surrounding the particular bankruptcy case." As to the first factor, the bankruptcy court did not err by considering several of the debtor's paystubs (including some the debtor earned after receiving a recent raise) rather than focusing exclusively on her higher, most recent paystub, and "even if the Bankruptcy Court used the figure suggested by North Dakota, [the debtor's] income would still not enable her to make \$450 monthly payments." Moreover, that the debtor had left a higher paying job was not controlling because the debtor's current job permitted her to avoid daycare expenses, and she was working full time in her field of education. The bankruptcy court also did not err in concluding that the debtor's income was not likely to increase in the future in an amount sufficient to support the \$450 student loan payment and her living expenses. As to the second factor, "though some expenses may toe the line of reasonable and necessary, the Debtor's frugality in other areas is relevant" and the debtor's efforts to share a car and avoid daycare expenses, decision to live in a three-bedroom apartment with three children, and buying of secondhand clothing, among other circumstances, evidenced sufficient frugality. As to the third factor, other relevant circumstances weighed in favor of discharge. In particular, the debtor's status as co-signor significantly affected the court's analysis under this factor, and (along with evidence that the debtor's mother had represented that she "was taking care of the debt") mitigated some circumstances that might otherwise have weighed against discharge. Thus, the cosigned debt was dischargeable.

J. Counsel Did Not Clearly and Conspicuously Explain Services to Be Provided to Chapter 7 Debtors When Agreements Attempting to Bifurcate Pre-Petition and Post-Petition Services Included Overlapping Descriptions of Work and Confusing Language About Counsel's Commitment to Provide Services Even if the Debtors Did Not Enter into the Second Agreement. *In re Baur*, 658 B.R. 930 (Bankr. E.D. Mo. 2024) (en banc).

Five debtors employed the same counsel for their routine chapter 7 cases. Because of § 330(a)(1), a debtor's attorney is prohibited from receiving payment from a bankruptcy estate post-petition unless the attorney is also employed by the trustee. In practice, this means that counsel for a chapter 7 debtor needs to be paid in full pre-petition.

Counsel here, however, entered into two agreements with each of the debtors that purported to bifurcate services between those performed pre- and post-filing. Under the first (pre-filing) agreement, the debtors were not required to pay counsel for the services provided, but those services purported to be limited to pre-filing services, such as preparing a bare-bones petition. However, the first agreement also included disclaimers stating that counsel would, "[c]omplying with Local Rule 2093 C 3 [sic], . . . provide all legal services necessary for representation of [the debtors] in connection with the bankruptcy case[s] until conclusion of the case[s] regardless of [the debtors] signing a post petition agreement or making post petition payments."

Under the second (post-filing) agreement, which mostly duplicated what was included in the first agreement, counsel agreed to perform all necessary services for completion of the debtors' cases in exchange for a fee of \$1,462. A similar disclaimer was included, stating:

If you choose not to sign this Post-Filing Agreement, we still will provide to you any legal service required by the local rules of the bankruptcy court and 1 U.S.C. § 521(a)(1)(B) [sic], Section 526(c)(2)(B), and L.B.R. 9010-1(c) of the Bankruptcy code [sic]. Complying with Local Rule 2093 C 3 [sic] and the Bankruptcy Code, our attorney will provide all legal services necessary for representing you in connection with the bankruptcy case until conclusion of the case regardless of you signing a post petition agreement or making post petition payments. We will handle your case from start to finish unless the bankruptcy court allows us to withdraw for important reasons or you terminate our services.

Reviewing the convoluted agreements in depth, the en banc court found that the agreements were not clear, as required by § 528(a)(1). That section requires a debt relief agency, which includes a consumer bankruptcy attorney, to execute a written

contract with a debtor that clearly and conspicuously explains the services the agency will provide and the fees and charges for those services. Because the agreements, both independently and when read in conjunction with one another, failed to coherently explain the services to be provided, they were not clear. Specifically, it was impossible to decipher which services were to be performed under which contract, particularly in light of the inclusion of the disclaimer language in each contract.

Accordingly, the agreements were void under § 526(c)(1) and unenforceable by anyone other than the debtors. Furthermore, because counsel's violation of § 528 was at least negligent, counsel was obligated to refund any fees and charges received to the debtors.

# K. Wife Entitled to File Chapter 7 Petition on Debtor's Behalf as Next Friend but Not as Representative. *In re Rivas*, 656 B.R. 898 (Bankr. E.D. Mo. 2023) (Walsh, J.).

Mr. Rivas suffered from health issues that made him unable to process complex information or manage his financial resources. His wife of 28 years, who was also his attorney in fact, filed a joint chapter 7 petition on behalf of herself and Mr. Rivas, then filed a motion to waive Mr. Rivas' credit counseling and financial management course requirements.

The court first analyzed the threshold question of whether Mrs. Rivas was entitled to file the chapter 7 petition on her husband's behalf. Under Rule 1004.1 of the Federal Rules of Bankruptcy Procedure, an "incompetent person" who has a "representative" (defined as "a general guardian, committee, conservator, or similar fiduciary") may file a voluntary petition through that representative. incompetent person who lacks a representative may file by "next friend." Neither the Bankruptcy Code nor Missouri law defines the term "incompetent person." But Missouri law authorizing certain people to make financial decisions on behalf of statutorily defined "disabled person[s]" was sufficiently analogous. Consequently, "a debtor who is 'disabled' under Missouri law is 'incompetent' for purposes of Rule 1004.1." Mrs. Rivas, however, was not a "representative" within the meaning of Rule 1004.1. She was not "a general guardian, committee, conservator" under that And her status as his attorney in fact did not make her a "similar fiduciary"—attorneys in fact lack two key characteristics that general guardians, committees, and conservators share: (1) court appointment and supervision, and (2) centralization of decision-making power. Nonetheless, Mrs. Rivas was entitled to file the bankruptcy petition as Mr. Rivas's next friend. A next friend may act on behalf of an incompetent debtor if the next friend provides an adequate explanation about why the debtor could not act on his own behalf, is truly dedicated to the debtor's best interests, and has a significant relationship with the debtor. Because

Mrs. Rivas satisfied those requirements, her filing of the petition on Mr. Rivas' behalf was valid. Having resolved the threshold question, the court summarily appointed Mrs. Rivas as Mr. Rivas's guardian ad litem under Rule 1004.1 and granted the motion to waive Mr. Rivas's credit counseling and financial management course requirements due to his incapacity.

# III. Tenth Circuit

A. Earmarking Defense Applied to Defeat Fraudulent Transfer Action. *Montoya v. Goldstein (In re Chuza Oil Co.)*, 88 F.4th 849 (10th Cir. 2023) (Tymkovich, J.).

Debtor Chuza Oil Co. was an unprofitable petroleum production company that twice landed in bankruptcy. The defendants were insiders of the debtor: one held a subordinated note, and the other two guaranteed the note. In the debtor's first bankruptcy case, a chapter 11 case filed in 2014, the debtor's confirmed chapter 11 plan separately classified general unsecured creditors from the insider subordinated note creditors and required payment in full of all general unsecured creditors before paying the insider subordinated note. Due to the debtor's continued unprofitability after confirmation, the defendants loaned hundreds of thousands of dollars to the debtor post-confirmation so the debtor could make its plan payments and continue operating. From the loaned funds, the debtor made payments on the subordinated note even though general unsecured creditors had not been paid in full. The postconfirmation insider loans were not enough to keep the debtor afloat. In 2018, an involuntary chapter 7 petition was filed and an order for relief was entered commencing the debtor's second bankruptcy case. The chapter 7 trustee sued the insiders to recover the subordinated-note payments as preferential transfers, actually fraudulent transfers, and constructively fraudulent transfers. bankruptcy court declined to avoid the payments, determining the debtor did not have an interest in the transferred funds within the meaning of the preference and transfer statutes because subordinated-note payments "earmarked" for payment to the subordinated noteholder. The BAP reversed, determining the earmarking doctrine did not apply because the subordinated-note payments injured the debtor's creditors by replacing the debtor's subordinated debt with unsubordinated debt.

The Tenth Circuit first concluded the BAP applied the correct test to determine whether the earmarking doctrine applies. A court may only avoid preferential or fraudulent transfers if the debtor had an interest in the property transferred. Under the earmarking doctrine, when a debtor incurs new debt to make payments on existing debt, the debtor lacks an interest in the funds paid toward existing debt—and the transfers may not be avoided—if the new lender "earmarks" the funds for the existing creditor. But earmarking does not apply to protect a transfer if either: (1) the debtor retained some dominion or control of the transferred funds, or (2) the transfer diminished the bankruptcy estate.

But the Tenth Circuit disagreed with the BAP's application of the earmarking doctrine to reverse the bankruptcy court—largely because the Tenth Circuit concluded bankruptcy court's inferences in support of its application were not clearly erroneous. First, the bankruptcy court did not err in concluding the debtor lacked dominion or control over the subordinated-note payments because the debtor could only use the relevant funds to pay the subordinated noteholder. That the debtor had possession of the funds before transferring them to the subordinated noteholder was not determinative. Second, the bankruptcy court did not clearly err in determining that the overarching transaction between lenders, the debtor, and the subordinated noteholder did not diminish the estate. Because the total loan payments to the estate exceeded the amounts paid to the subordinated noteholder. the net effect of the loan payments into the estate (payments conditioned on further payment of a portion to the subordinated noteholder) was to enrich the estate by almost \$400,000. Thus, the earmarking doctrine applied. Finally, because the bankruptcy court did not err in determining the new loans were in exchange for the debtor's promise to pay a portion to the subordinated noteholder ("rather than the contrary interpretation that only part of the loan came with the condition to pay [the principal's mother]"), the lower court also did not err in determining, in the alternative, that the contemporaneous exchange for new value defense applied.

B. Tenth Circuit Declines to Rule on Merits of BAP Decision Determining Deadline to File Notice of Appeal Is Not Tolled by Erroneous Extension of the Deadline to File Motion to Reconsider. Lane v. Witt (In re Witt), No. 23-1035, 2023 WL 8524923 (10th Cir. Dec. 8, 2023) (unpublished) (Carson, J.).

For many years, creditor Noel Lane sought to prove that the debtor and others committed mortgage fraud against him. After the debtor filed a bankruptcy petition, Lane attempted to use the bankruptcy court as a forum to litigate issues surrounding physical boxes allegedly containing information relevant to the mortgage fraud dispute. The court warned Lane that the bankruptcy court was not the proper forum to resolve disputes relating to the boxes. Lane nonetheless subsequently filed an adversary proceeding relating to the boxes. The bankruptcy court dismissed the adversary proceeding and imposed sanctions against Lane. Lane then moved to extend the deadline to file a motion for reconsideration of the sanctions order but did not request an extension of the deadline to appeal. The bankruptcy court granted the motion to extend time to request reconsideration and Lane filed his motion for reconsideration before the extended deadline. The bankruptcy court then denied the motion for reconsideration. Lane filed a notice of appeal, seeking reversal of the bankruptcy court's orders dismissing his adversary proceeding, imposing sanctions, and denying his motion for reconsideration. Lane appealed first to the BAP.

The BAP concluded it lacked appellate jurisdiction to review the dismissal order and sanctions order because Lane did not properly preserve appellate review of

those orders. Regarding the dismissal order, Lane did not file his notice of appeal until well after the 14-day deadline to file a notice appeal under Rule 8002. Regarding the sanctions order, though a motion for reconsideration under Rule 9023 can toll the time to file a notice of appeal, the deadline for filing a motion for reconsideration cannot be enlarged per Rule 9006(b)(2). Moreover, "an untimely Rule 9023 motion is ineffective to toll the time to file a notice of appeal." As a result, the BAP determined the bankruptcy court erred in granting Lane an extension of the deadline to file his motion for reconsideration, the appeal deadline was not tolled, and Lane did not file a notice of appeal within the deadline.

The Tenth Circuit "decline[d] to consider the merits of the BAP's conclusion that it lacked jurisdiction over Lane's appeal," but nonetheless affirmed. Before the Tenth Circuit, Lane "failed to adequately brief the jurisdictional issues and [instead] leveled baseless accusations at the courts." Specifically, Lane argued the court should excuse his untimely notice of appeal because he (1) merely "identified the incorrect order from which to measure the time to appeal" and (2) "confused Rule 8002(a)(1)'s fourteen-day period for filing a notice of appeal with Federal Rule of Appellate Procedure 4(a)(1)(A)'s thirty-day period." The court concluded neither argument invoked appellate review because Lane's arguments were "conclusory and unsupported by legal authority." The Tenth Circuit also found Lane's third argument—that he was a victim of institutional bias based on his status as a pro se litigant—lacking merit. The relevant rulings showed no unfair treatment, and courts must apply procedural rules equally to pro se and counseled litigants.

C. Bankruptcy Court Did Not Abuse its Discretion in Declining to Deem Creditor's Prior Filings Informal Proofs of Claim. Gould v. Falcon Strategic Partners IV (In re Integrity Directional Servs. LLC), No. 23-6111, 2024 WL 3534368 (10th Cir. July 25, 2024) (unpublished) (Matheson, J.).

The creditors filed a proof of claim in the debtor's chapter 7 case two days after the claims bar date. About a week later, the creditors filed a motion asking the bankruptcy court to consider their filing an amendment to prior, informal proofs of claim and relate the proof of claim back to the date of a prior motion for relief from stay. The chapter 7 trustee opposed the motion, and the bankruptcy court denied it, applying *In re Reliance Equities, Inc.*, 966 F.2d 1338 (10th Cir. 1992). The five factors used in *Reliance* to determine whether a filing should be considered an informal proof of claim are stated in the conjunctive; they must all be present: "1. the proof of claim must be in writing; 2. the writing must contain a demand by the creditor on the debtor's estate; 3. the writing must express an intent to hold the debtor liable for the debt; 4. the proof of claim must be filed with the Bankruptcy Court; and 5. based on the facts of the case, it would be equitable to allow the amendment." The bankruptcy court concluded neither the second, third, or fifth

factor was satisfied, and denied the motion. On appeal, the district court reversed and remanded, concluding the bankruptcy court erred in its conclusion the creditors had not shown a demand (factor two) or intent (factor three) and abused its discretion in considering the equities.

The Tenth Circuit first addressed its jurisdiction. It concluded the district court's order was final under 28 U.S.C. § 158(d) despite containing a remand, because the remand order was ministerial only and did not require further findings or proceedings.

The Tenth Circuit then reversed the judgment of the district court and affirmed the bankruptcy court, focusing on the fifth *Reliance* factor, whether the equities favored allowing the informal proof of claim. The bankruptcy court relied on the creditors' sophistication and representation by experienced counsel, the creditors' knowledge of the bar date, and the creditors' failure to put forth a "compelling reason" for missing that bar date. The district court agreed with that analysis but relied on "other equitable considerations" it believed outweighed those factors. The Tenth Circuit concluded the bankruptcy court's analysis was a "reasonable and a permissible choice between competing equitable considerations," and therefore not an abuse of discretion. Because the Tenth Circuit concluded the bankruptcy court did not abuse is discretion in concluding the creditors had not satisfied the fifth factor, and all factors must be present to find an informal proof of claim, the Circuit concluded it need not assess the other factors and affirmed the bankruptcy court's judgment.

# D. Article III Standing Requirement Applies to Bankruptcy Courts. Pettine v. Direct Biologics, LLC (In re Pettine), 655 B.R. 196 (B.A.P. 10th Cir. 2023) (Jacobvitz, J.).

Though the chapter 7 debtor in this case had an ownership interest in the LLC that became property of the estate, transfer restrictions in the LLC's operating agreement prevented the chapter 7 trustee from selling the ownership interest. So, the trustee instead sought a charging order against a debtor's right to receive distributions from the LLC and asked the bankruptcy court to approve a sale of the charging order. The debtor and LLC objected. The bankruptcy court determined the debtor lacked standing to challenge the issuance of the charging order and issued the charging order against the debtor's interest.

The BAP reversed the bankruptcy court's decision that the debtor lacked standing, but affirmed its decision that the trustee was entitled to the charging order on the merits. The case required the BAP to analyze as a preliminary matter whether the Article III standing requirement applied to bankruptcy courts—an issue that has split the Circuits. Disagreeing with *Kiviti v. Bhatt*, 80 F.4th 520 (4th Cir. 2023) (in

which the Fourth Circuit recently concluded that Article III constraints do not apply to bankruptcy courts because bankruptcy courts are not Article III courts and no statute imposes Article III constraints on bankruptcy courts), the Tenth Circuit BAP determined the Article III standing requirement applies to bankruptcy courts. The BAP explained that the relevant statutory provisions, 28 U.S.C. § 157 and 28 U.S.C. § 1334, do not give jurisdiction to bankruptcy courts but instead authorize district courts to exercise jurisdiction over bankruptcy cases and refer those cases to bankruptcy courts. "Because Article III limits district court jurisdiction to adjudicating cases and controversies, and the derivative nature of bankruptcy court jurisdiction means that it cannot extend beyond the jurisdiction of the district court, bankruptcy court jurisdiction is also so limited to adjudicating cases and controversies." Any contrary ruling would make essential components of § 157 unenforceable or unworkable. The court next determined the debtor had standing to challenge the charging order even though no surplus equity existed to give the debtor a pecuniary interest in the trustee's administration of the estate. charging order caused an injury in fact to the debtor that was fairly traceable to the challenged conduct and that would be redressed by a favorable ruling. Specifically, absent the charging order, the transfer restriction on the debtor's membership interest in the LLC would render that interest of inconsequential value and benefit to the estate, and the interest would likely be abandoned to the debtor under 11 If abandoned and not encumbered by a charging order, the membership interest in the LLC would have pecuniary value to the debtor. Thus, the debtor had Article III standing. The debtor also had prudential standing because he was asserting his own legal right to the abandonment of the membership interest and was not asserting the rights of a third party. On the merits, the BAP determined that the bankruptcy court did not err by issuing the charging order. Under 11 U.S.C. § 544, the trustee had the rights and powers of a hypothetical judicial lien creditor. The charging order was a form of judicial lien because it acted as a charge against property to secure payment of a debt. Thus, "the Charging Order simply effectuated the Trustee's rights and powers of a hypothetical creditor that obtained a charging order against the Membership Interest at the time [the debtor] commenced his bankruptcy case," and therefore, was proper under § 544.

E. Section 523(a)(2)(A) Requires Proof of Justifiable Reliance Unless Fraud is Not Type that Induces Reliance. *Grange Ins. Ass'n v. Woods (In re Woods)*, 660 B.R. 905 (B.A.P. 10th Cir. 2024) (Jacobvitz, J.).

Prepetition, a state court entered a judgment against the debtors for insurance fraud, based on the debtors submitting claims for payment with fabricated documentation (submitting a receipt for \$3,825 for a mower and a receipt for \$2,900

for a ring). Because the state court concluded the fraudulent conduct triggered a fraud provision in the insurance policy at issue, the state court entered judgment against the debtors for a total of \$582,133.79, the amount of the benefits that had been paid under the policy and costs. The debtors then filed a chapter 7 petition, and the insurance company initiated an adversary proceeding seeking to have the judgment debt declared nondischargeable. The bankruptcy court concluded the state court judgment should be given preclusive effect to establish the debtors obtained the debt against them by actual fraud and in the alternative, that there was no genuine dispute of material fact the insurance creditor justifiably relied on the debtors' fraud under § 523(a)(2)(A). The bankruptcy court declared the entire judgment debt nondischargeable as to both debtors, despite one debtor declaring he was an innocent spouse.

On appeal, the BAP reversed and remanded. The BAP concluded the bankruptcy court erred by holding the insurance company was not required to prove reliance to establish a nondischargeable actual fraud claim under § 523(a)(2)(A). The BAP interpreted the Supreme Court's decisions in *Husky Int'l Elecs., Inc. v. Ritz*, 578 U.S. 355 (2016), and *Field v. Mans*, 516 U.S. 59 (1995), and concluded proof of reliance is not required under § 523(a)(2)(A) only if the fraud at issue is not a type that induces reliance, like a fraudulent conveyance scheme. But proof of justifiable reliance is required if a false representation is at issue, like in the case at hand, where one of the debtors submitted fabricated documentation to the insurance company to induce the company to pay the claims.

The BAP concluded the state court insurance fraud judgment established the debtor made false representations with intent to deceive. But the BAP also concluded that while the nondisputed facts established the insurance company relied on the debtor's false representation about the mower, the nondisputed facts did not establish the same regarding the ring because it made no payment on the claim regarding the ring. And finally, regarding the justifiability of the insurance company's reliance, the BAP assessed the evidence and concluded there were material facts in dispute, requiring remand to the bankruptcy court for a determination whether the insurance company justifiably relied on the false representation relating to the mower. Finally, the bankruptcy court on remand would also need to determine whether the insurance company sustained a loss by paying on the claim for the mower, as there were disputed facts as to whether the insurance company's bank account was ever debited for any amount that represented payment of the claim for the mower. Regarding the amount sought to be nondischargeable—i.e., the entire \$582,122.79—the BAP determined because there were disputed facts as to whether the insurance company "suffered an actual loss, which appears from the record to be at most \$1,186.58," the BAP would "decline to reach the issue of whether an actual loss of \$1,186.58 can give rise to a

nondischargeable debt of \$582,122.79." Finally, because the bankruptcy court was reversed in its finding of nondischargeability, the BAP also did not reach the issue of whether one debtor was an innocent spouse.

F. Conversion to Chapter 7 Eliminates Debtor's Absolute Right to Dismiss a Chapter 13 Case. *Pino v. Martinez (In re Pino)*, 657 B.R. 264 (B.A.P. 10th Cir. 2024) (Herren, J.).

The debtor appealed the bankruptcy court's order denying his motion to voluntarily dismiss his case under § 1307(b). The issue presented on appeal was whether a debtor has an absolute right to dismissal under § 1307(b) after conversion of a case to chapter 7.

The debtor filed his chapter 13 bankruptcy in 2022, shortly before a trial was to commence on a state court action brought against the debtor for breach of contract and other claims arising out of the purchase of real property from the debtor in 2017. The purchasers were the only creditors in the case and filed a proof of claim in excess of \$1,000,000. The purchasers objected to confirmation of the debtor's plan on the grounds that the debtor exceeded the statutory debt limits and was not eligible for chapter 13, the plan was not proposed in good faith, and the plan did not comply with the best interest of creditors test. The purchaser also filed a motion under § 1307(c) to dismiss the debtor's case, or in the alternative, to convert the case to chapter 7 based on the debtor's eligibility and bad faith. The bankruptcy court entered an order converting the case to chapter 7, finding that the debtor's unsecured debts exceeded the chapter 13 limits, and the debtor was ineligible for chapter 13 relief. The debtor did not appeal the conversion order. Two months later, the debtor filed a motion to set aside the conversion order under Rule 60(b) seeking to retroactively stay the conversion order to give the debtor an opportunity to voluntarily dismiss the case. The debtor also filed a motion to dismiss under § 1307(b) or transfer case for change of venue. The bankruptcy court denied the Rule 60(b) motion, denied the venue transfer, and denied the motion to dismiss because the debtor was no longer a chapter 13 debtor, the case having been previously converted to chapter 7.

The BAP concluded that when applying basic principles of statutory interpretation, including the plain language or meaning of a statute, a particular statutory provision cannot be viewed in isolation, but also requires the court to consider the plain meaning of the broader, statutory framework. The debtor seized on the plain language of § 1307(b), the chapter 13 provision that allows a debtor to voluntarily dismiss a case "at any time," but ignored the plain language in that statute that mandates dismissal of a case "under this chapter." That language makes clear that § 1307(b) applies to a case under chapter 13. That is also consistent with the Code's general provision regarding applicability of chapters, § 103(j), which states that

chapter 13 of the Code only applies in cases under chapter 13, and with *Harris v. Viegelahn*, 575 U.S. 510 (2015), which notes that chapter 13 provisions do not apply to a case in chapter 7 after conversion. The debtor was no longer in chapter 13 when he filed his motion to dismiss because the chapter 13 case had been converted to chapter 7 two months prior. The prior conversion order cut off the debtor's absolute right to dismiss his chapter 13 case under § 1307(b). The bankruptcy court's denial of the debtor's motion to dismiss under § 1307(b) was, therefore, affirmed.

G. Debtor's Agreement to Pay a Portion of Business Loan and Eventual Payment Under the Agreement Constituted Reasonably Equivalent Value for Loans and Satisfaction of Debt. *Bird v. Wardley (In re White)*, No. UT-22-008, 2024 WL 698232 (B.A.P. 10th Cir. Feb. 21, 2024) (Michael, C.J.) (unpublished).

Pre-petition, the individual chapter 7 debtor owned businesses that marketed and sold discount medical cards. A creditor agreed to loan the debtor funds for use in a new discount medical card business. The creditor and debtor, however, did not memorialize their lending agreement in writing until months later, after the lender had already begun advancing funds. The after-the-fact writing, together with an employment agreement, gave the lender a majority ownership interest in the new medical card business, gave the debtor a much smaller percentage, made the debtor "personally liable for repayment of \$750,000 of the monies loaned," and authorized the debtor to manage the medical card business and receive a salary in an amount the debtor could determine at his sole discretion. The debtor's promise to repay \$750,000 of the total amount loaned was secured by the debtor's interest in a \$15 million judgment the debtor had obtained against a third party. When the medical card business underperformed, the debtor paid the creditor \$750,000 in proceeds from the debtor's judgment against the third party. Years later, the debtor filed a chapter 7 petition. The chapter 7 trustee filed an adversary proceeding seeking to avoid and recover the \$750,000 payment to the creditor under the Utah Uniform Fraudulent Transfer Act. The trustee argued, in relevant part, that the debtor did not receive reasonably equivalent value for his original agreement to pay \$750,000 and did not receive reasonably equivalent value in exchange for his eventual payment of that amount. Before the bankruptcy court, the debtor and creditor "testified without contradiction that the advances of funds from [the creditor] were direct loans to [the debtor]," rather than to the company. The bankruptcy court entered summary judgment in favor of the creditor and against the trustee and dismissed the trustee's claims for relief. The trustee appealed.

The BAP affirmed. At the outset, the debtor received value in exchange for his agreement to repay \$750,000. Quoting the Third Circuit's decision in *Mellon Bank*,

N.A. v. Official Committee of Unsecured Creditors of R.M.L., Inc. (In re R.M.L., Inc.), 92 F.3d 139 (3d Cir. 1996), the BAP explained that the opportunity to receive future economic value constitutes reasonably equivalent value when there is "some chance that a contemplated investment will generate a positive return." In exchange for the debtor's agreement to repay a portion of the amounts loaned the debtor received value in the form of all the benefits associated with the loans: a chance at future returns, an opportunity to partially own and operate the medical card business, and a lucrative salary. The fact that the loan proceeds were deposited in the business' bank account did not undermine the benefits to the debtor; the debtor used the business bank account as his own (and did not have a personal bank account where the funds could have been deposited instead) and had sole discretion over the use of the proceeds in the business account. Thus, the benefits the debtor received in exchange for his agreement to repay \$750,000 were reasonably equivalent to that The bankruptcy court also did not err in determining the debtor received reasonably equivalent value in exchange for the \$750,000 payment itself. In exchange for the amounts paid, the debtor received a dollar-for-dollar credit against his obligation to repay the \$750,000 loan. The debtor's obligation to repay was not contingent, and, therefore, constituted an antecedent debt within the meaning of the relevant fraudulent transfer law. Thus, the bankruptcy court did not err in dismissing the trustee's claims for relief.

H. Loss of Inchoate Interest in Marital Property at Dismissal of Divorce Proceeding Did Not Give Rise to Avoidance Liability. Walters v. Gallegos (In re Gallegos), 73 Bankr. Ct. Dec. 31 (B.A.P. 10th Cir. 2023) (Thurman, J.) (unpublished).

Pre-petition, the debtor's husband filed a divorce case in Colorado. The filing of the divorce case created a marital estate that gave the debtor a vested interest in the appreciation in value in her husband's premarital property under Colorado law. After the debtor commenced her chapter 7 bankruptcy case, she and her husband stipulated to the dismissal of the divorce case. In an avoidance action, the chapter 7 trustee filed a partial motion for summary judgment seeking a determination that the dismissal of the divorce case constituted an avoidable post-petition transfer of the debtor's interest in marital property. The bankruptcy court denied the partial motion for summary judgment.

The BAP agreed with the bankruptcy court. The trustee had no greater rights to or control over the marital estate than the debtor had. Under Colorado law, the filing of a divorce petition creates a vested equitable interest in the marital estate, but the value of that estate is not determined until the entry of the divorce decree or hearing on property disposition. Thus, if a divorce proceeding remains pending when a debtor files bankruptcy petition, the debtor's interests are vested but

undefined and inchoate at that time. "Such an undefined, inchoate interest does not survive dismissal of the related divorce action," and, as a result, dismissal does not give rise to an avoidable transfer. A contrary determination would "run counter to Colorado public policy" in favor of promoting reconciliation. Accordingly, the BAP affirmed the bankrufptcy court's denial of the trustee's motion for partial summary judgment.

# I. Court Declines to Delay Effect of Lien Avoidance Pending Discharge. *In re Guzman*, 660 B.R. 149 (Bankr. D. Colo. 2024) (Rosania, J.).

Chapter 13 codebtors moved to avoid a judgment lien and sought plan confirmation. The judgment lien creditor objected to the motion to avoid the judgment lien but did not oppose confirmation. Though the creditor agreed that lien was avoidable under § 522(f), it asked the court to delay the effect of lien avoidance to ensure the debtors sell the property after lien avoidance then dismiss their case without discharge. The creditor explained that § 349(b)(1)(B) ordinarily operates to reinstate creditors' avoided liens when a case is dismissed without discharge. But if the property that was subject to an avoided lien is sold before dismissal, dismissal does not reinstate the lien because the lien cannot reattach to property after the sale. Summarizing three different approaches courts had taken to preventing debtors from receiving a windfall under those circumstances, the creditor asked the court to impose three conditions to any order avoiding its lien: (1) lien avoidance would not be effective until discharge; (2) if the debtors sold the property during the case, the chapter 13 trustee would hold any proceeds pending discharge; and (3) the debtors could not record the order avoiding the creditor's lien until discharge.

The court granted the debtors' motion to avoid the lien without imposing any of the conditions the creditor requested. The court explained that under Colorado law, "unless equity exists above the homestead exemption, the judicial lien does not attach in the first instance" outside of bankruptcy. There was no equity above the available exemption here, so the lien never attached. Moreover, in the Tenth Circuit, the estate terminates and property of the estate vests in the debtor when a plan is confirmed unless the plan provides otherwise, and as a result, "a court cannot place restrictions on the lawful use or sale of the property" after confirmation. Here, the property had vested in the debtors at confirmation, so the court could not belatedly restrict the debtor's use of the property. Finally, the court concluded "there can be no reading of 11 U.S.C. § 522(f) that allows a court to impose restrictions in contravention of and beyond the plain language of the statute conditioning how or when the judicial lien is avoided."

J. Debtor Obtains Student Loan Discharge Under Brunner. Ester v. Penn. Higher Ed. Assistance Agency (In re Ester), 657 B.R. 655 (Bank. N.D. Okla. 2024) (Michael, J.).

Quoting an opinion he penned 27 years ago, Judge Michael begins this student loan discharge opinion by announcing, "[t]he burden of a debt which can never realistically be repaid constitutes an undue hardship. The debtor must be able, at least over the long haul, to slay the beast, not merely keep it at bay." Concluding that the debtor in this case could never realistically have slayed his student loan beast, Judge Michael held that the student loans were dischargeable under *Brunner v. N.Y. State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987) and related Tenth Circuit authority.

The debtor took out student loans in 2007, decided not to continue his education due to the debt burden in 2010 (he received no degree), and defaulted on his student loans by 2012. Pre-petition, his student loan debt had been reduced to judgment, and the student loan creditor had begun garnishing his wages at a rate of \$900 per month. The debtor was a 45-year-old, single man with no dependents. He was living a frugal lifestyle and was earning \$25 per hour at a job where he was not consistently offered 40 hours of work per week. Injuries from his military service made future overtime work unrealistic. His average income and expenses left him with very little to no future disposable income per month. The first Brunner factor required the court to consider whether the debtor could maintain a minimal standard of living if required to pay his student loans. The debtor had very few discretionary expenses in his budget (satellite television service, charitable contributions, and an IRA contribution) and intended to remove those expenses to pay a different student loan debt under the terms of a negotiated settlement. Because the debtor lacked sufficient liquid assets to pay the student loan debt and lacked sufficient disposable income to pay the creditor an ongoing student loan payment and sustain his necessary expenses, the first factor was satisfied. The second factor, whether the "state of affairs is likely to persist for a significant portion of the repayment period" was also satisfied. The debtor had lost previous employment for requesting higher pay and was unlikely to increase his earning potential without further education—something he could not afford. The court declined to demand the debtor find a roommate because the debtor did not know any trustworthy available roommates and was reasonably "wary of inviting strangers to live in his home." His modest expenses would also persist. As to the third Brunner factor, whether the "debtor has made a good faith effort to repay [his] student loans," the court determined the debtor had sufficiently attempted to maximize income and minimize expenses by seeking overtime work and living a "spartan" lifestyle (he "drives an old car, eats a single meal a day, and does not indulge in personal entertainment"). The creditor, not the debtor, had prevented

settlement of this debt under a more affordable repayment plan. Finally, the court declined to "determine a nondischargeable amount and then craft an acceptable payment schedule for the nondischarged debt," concluding "the entire balance of the loan should be discharged."

# K. Panel Trustees: to Receive Compensation Following Conversion to 13, Keep Time Records. *In re Cummings*, 659 B.R. 895 (Bankr. D.N.M 2024) (Jacobvitz, J.).

While the case remained in chapter 7, the chapter 7 trustee discovered sufficient, formerly undisclosed non-exempt equity in the debtor's residence to pay all general unsecured claims in full. To retain the residence, the debtor promptly moved to convert her case to chapter 13, and the case was converted before the trustee could make any distributions to unsecured creditors. The chapter 7 trustee subsequently sought a \$12,500 administrative expense claim against the converted chapter 13 estate, arguing that the general unsecured creditors would not have received any distribution absent the trustee's work.

Sections 330 and 326 govern compensation of chapter 7 trustees. Section 330(a)(1) "reasonable compensation for actual necessary services" "reimbursement for actual, necessary expenses." Section 330(a)(7) directs the court to determine a trustee's compensation based on § 326, which in turn limits compensation based on scaled percentages of amounts distributed by "the trustee." The court described "three main categories" of approaches courts take to awarding compensation to a chapter 7 trustee who made no distributions before conversion: (1) cap compensation to the chapter 7 under § 326(c) based on the funds distributed by the chapter 13 after conversion, (2) do not cap compensation under § 326(c), or (3) award nothing. The court first declined to determine the chapter 7 trustee's compensation based on the amounts distributed by the chapter 13 trustee after Under the plain language of § 326(c), "the trustee" receiving conversion. compensation must also be "the trustee" who made the distributions. Thus, the former chapter 7 trustee's compensation could not be based on the chapter 13 trustee's distributions here. But § 326(c) does not preclude compensation of a former chapter 7 trustee because (1) § 326(c) only governs while the case remains in chapter 7 and (2) the language in § 330(a)(7) that incorporates § 326(c) logically must not universally impose § 326(c)'s compensation scheme on all trustees paid under § 330 because § 330 broadly applies to trustees who receive compensation under other established schemes, such as United States trustees and subchapter V trustees. Thus, the court rejected the conclusion that § 326(c) prohibits compensation to former chapter 7 trustees. Though the court concluded that former chapter 7 trustees may receive some compensation, it declined to premise its award of compensation on the equitable theory of quantum meruit, explaining that the

relevant provisions of the Code "exclusively govern allowance of compensation to a chapter 7 trustee." Ultimately, the court turned to § 330(a)(1) which "expressly applies to compensation of trustees," noting that "no other statutory provision makes § 330(a)(1) inapplicable to a chapter 7 trustee in a converted chapter 13 case who did not earn a commission while the case was pending under chapter 7." Using the lodestar formula, § 330, and other governing factors and authority, the court awarded the trustee \$2,500 plus reimbursement of expenses and gross receipts taxes.

# IV. Other

A. Bankruptcy Court Automatically Retains Post-Dismissal Jurisdiction to Grant Fee Requests under § 303(i). Reyes-Colon v. Banco Popular de P.R., 110 F.4th 54 (1st Cir. 2024) (Montecalvo, J.).

The bankruptcy court dismissed the debtor's involuntary chapter 11 case because only two creditors joined the petition. A year later, the debtor filed a fee application under § 303(i)(1)—seeking over \$900,000 from the petitioners, alleging they forced the debtor into bankruptcy in bad faith. The petitioners argued that the bankruptcy court lacked subject matter jurisdiction because the case was closed. The bankruptcy court agreed. The debtor appealed, and the district court affirmed the bankruptcy court. The debtor appealed to the First Circuit.

Section § 303(i)(1) allows debtors to recover fees from petitioners for involuntary cases filed in bad faith. The petitioners argued that the bankruptcy court must include jurisdiction-retaining language in its dismissal order to retain jurisdiction over post-dismissal § 303(i)(1) fees. The petitioners asserted that the bankruptcy court loses jurisdiction over all matters when it dismisses the case.

The First Circuit rejected this argument. Judge Montecalvo, writing for a unanimous panel, first noted that § 303(i) fee applications fall under the bankruptcy court's "arising under jurisdiction" because the cause of action is created by the Bankruptcy Code. She focused on the plain text of § 303(i) which does not say the bankruptcy court loses jurisdiction post-dismissal. Indeed, she emphasized that § 303(i) only allows the debtor to recover fees after dismissal if the involuntary petition was filed in bad faith. Moreover, § 349, listing the effects of dismissal, does not strip the bankruptcy court's jurisdiction over § 303(i) actions. Thus, not only can the bankruptcy court retain jurisdiction over § 303(i) actions, it must retain jurisdiction.

The First Circuit then determined that even though the bankruptcy court retained jurisdiction, because the fee application was filed more than fourteen days after the dismissal of the bankruptcy case, it was untimely under the district court's local rules.

B. The Taggart Standard Applies to Claim that Creditor Violated the Automatic Stay. Off. Comm. of Unsecured Creditors of Windstream Holdings, Inc. v. Charter Comms. Operating, LLC (In re Windstream Holdings, Inc.), 105 F.4th 488 (2d Cir. 2024) (Kahn, J.).

When the debtor, a telecommunications company, filed for bankruptcy, its competitor sent direct-mail advertisements to the debtor's current customers

suggesting that the debtor's future was uncertain. The debtor then filed an adversary proceeding against the competitor, alleging that the mail advertisements violated the automatic stay. Applying the *Taggart* standard, the bankruptcy court determined that the competitor did violate the stay and imposed sanctions. The District Court then reversed.

On appeal to the Second Circuit, the court first addressed whether the standard provided by the Supreme Court in *Taggart*, addressing violations of a discharge injunction, also applied to violations of the automatic stay. The court concluded that it does, given that both proceedings are guided by "traditional principles that govern civil contempt." Accordingly, the Second Circuit determined that a party can be found liable for a stay violation only when there is "no fair ground of doubt" that the conduct violated the terms of automatic stay.

In applying the *Taggart* standard, the court concluded that the competitor's advertisements did not constitute an "act to obtain possession of" or "exercise control" over the estate property. The competitor did not make misrepresentations or access the debtor's proprietary information. Furthermore, the automatic stay does not prevent a party from criticizing a debtor or informing others of its bankruptcy case. Accordingly, the court affirmed the decision of the district court that no sanctions should be imposed against the competitor.

# C. Order Denying Debtor's Motion to Dismiss Chapter 7 Case Not Final or Appealable. *Delaney v. Messer (In re Delaney)*, 110 F.4th 565 (2d Cir. 2024) (Park, J.).

The debtor, a lawyer proceeding pro se, moved to voluntarily dismiss his chapter 7 case. The bankruptcy court denied the debtor's motion to dismiss, concluding dismissal would not be in the best interests of all parties and rejecting the debtor's other arguments. The debtor appealed. The district court declined to hear the merits of the debtor's appeal, instead determining the denial was not a final appealable order. The district court also declined to give the debtor leave to bring an interlocutory appeal.

On appeal, the Second Circuit held that a denial of a debtor's motion to dismiss his or her case is a nonfinal, non-appealable order. Section 158 gives appellate courts jurisdiction over final orders. An order is final if it "conclusively determines all pending claims." "The bankruptcy court's order denying [the debtor's] motion to dismiss set the case on track for a final resolution on the merits. And the district court's dismissal of the appeal left work to be done in the bankruptcy court." As a result, "[t]he bankruptcy court's order denying [the debtor's] motion to dismiss his petition is nonfinal because it did not 'finally dispose of [a] discrete dispute[] within the larger bankruptcy case." The Second Circuit lacked jurisdiction to review the

district court's denial of the debtor's motion for leave to file an interlocutory appeal. Consequently, the Second Circuit dismissed the appeal.

D. Res Judicata May Bar a Creditor from Objecting to an Amended Chapter 13 Plan. *In re Smith*, 102 F.4th 643 (3d Cir. 2024) (Jordan, J.).

This controversy stems from debtor Tiffany Smith's Third Amended Plan. Smith owned a two-unit rental property that was secured by a mortgage held by Freedom Mortgage Corporation. The mortgage contained an "absolute assignment" of rents in which the debtor agreed to unconditionally assign and transfer rents and revenues to Freedom.

The debtor filed a plan but amended it before the original plan could be heard for confirmation. In the First Amended Plan, the debtor sought to cram down Freedom's claim, but proposed to continue to remit the rental income directly to Freedom to make payments on the secured portion of the claim. Freedom objected and protested the cramdown of its secured claim, the property's listed valuation, the property's rents being applied to reduce its secured claim, and the feasibility of the overall plan. At the hearing, Freedom ultimately conceded that it was not disputing the value of the property.

Following the hearing, the parties filed a consent order agreeing to the property value, cramdown of Freedom's claim, and delivery of all rental payments to the chapter 13 trustee, who would use such payments to pay down Freedom's secured claim. The parties agreed the consent order was to "be incorporated into and become part of any Order Confirming Plan." The court then confirmed the First Amended Plan, as modified by the consent order.

The debtor filed a Second Amended Plan to take advantage of certain provisions enacted by the CARES Act in response to COVID-19, specifically, increasing the length of her plan and imposing a step-up payment. The remaining terms mirrored the First Amended Plan. Freedom did not object and the Second Amended Plan was confirmed.

The debtor then filed a Third Amended Plan, seeking to extend the payment term again pursuant to the CARES Act. Again, the remaining terms mirrored the plans that had previously been confirmed. However, Freedom objected on the basis that (1) the use of rental income to pay the secured claim was foreclosed by *In re Jason Realty*, 59 F.3d 423 (3d Cir. 1995); (2) the plan's stepped-up monthly payments violated § 1325(a)(5)(B)(iii)(I); (3) the Property's cramdown valuation was too low and thus violated § 1325(a)(5)(B)(ii), and (4) the plan was not feasible. At the hearing on the objection, the Bankruptcy Court pointed out that many of Freedom's objections were the same ones they had made regarding the First Amended Plan,

but that they had consented to those terms then. Freedom argued the Third Amended Plan was a new plan that they had not consented to, and that nothing in the consent order required them to consent here. The Bankruptcy Court held that the issues of value, the use of the rents to pay down the secured claim, and the step up in payments were res judicate because of the Consent Order and Smith's Second Modified Plan. The Bankruptcy Court then confirmed the Third Amended Plan. The District Court affirmed the Bankruptcy Court.

The Third Circuit stated that § 1327(a) of the Bankruptcy Code effectively codifies the res judicata doctrine as it relates to confirmed bankruptcy plans. Citing the Supreme Court and itself, the Third Circuit went on to say that confirmation bars all challenges to the plan as well as any that *could* have been raised. And most importantly, though a debtor can modify a plan subject to § 1329(a), the Third Circuit held "that res judicata prevents creditors from challenging the terms of a previously confirmed bankruptcy plan, except for those terms that the debtor seeks to modify under § 1329 of the Bankruptcy Code."

E. Bankruptcy Courts May Adjudicate Cases that Would Be Moot in Article III Courts. *Kiviti v. Bhatt*, 80 F.4th 520 (4th Cir. 2023) *cert. denied*, 144 S. Ct. 2519 (2024) (Richardson, J.).

The Kivitis hired the debtor to renovate their home. The renovations were delayed and defective, and the debtor was not properly licensed. The Kivitis sued the debtor in Washington, D.C., court, and the debtor filed a chapter 7 bankruptcy case. The Kivitis filed a two-claim complaint against the debtor in bankruptcy court, alleging the debtor owed them \$58,770 under D.C. law and that the debt was nondischargeable. The bankruptcy court rejected the nondischargeability count and partially dismissed the adversary proceeding on summary judgment. The parties voluntarily dismissed the first count without prejudice to give rise to a final order the parties could appeal on the nondischargeability issue. The Kivitis appealed their nondischargeability loss to the district court, which affirmed it.

The Fourth Circuit found that the district court lacked jurisdiction to consider the appeal because the bankruptcy court's order was not final. It ruled that the parties cannot collude to create finality after the fact through a voluntary dismissal without prejudice.

The Kivitis argued that the first count was constitutionally moot with the dismissal of the nondischargeability count because they could not enforce the judgment outside of the bankruptcy claim and distribution process, which was proceeding on a different track, not in the adversary proceeding. Because the first count could not independently give them effectual relief, they argued it was moot. The Fourth Circuit rejected the argument, reasoning that "[m]ootness arises out of Article III's

'case-or-controversy' requirement. . . . But since bankruptcy courts are not Article III courts, they do not wield the United States's judicial Power. . . . So they can constitutionally adjudicate cases that would be most if heard in an Article III court." (citations omitted).

In response to the Kivitis's argument that bankruptcy courts derive their jurisdiction from the district courts' delegation of jurisdiction, the Fourth Circuit explained that Article III's limit on the district court's authority "does not require it be an Article III case or controversy for the bankruptcy court to act."

Noting that bankruptcy courts are "statutory creatures [that] have whatever power Congress lawfully gives him," the Fourth Circuit stated that:

Congress has said that bankruptcy courts 'may hear and determine *all* [bankruptcy] cases . . . and *all* core proceedings . . . referred' to them by a district court. . . . By § 157's text, a bankruptcy court's jurisdiction requires only that the case or core proceeding arise under Title 11 and be referred to the bankruptcy court. Section 157 does not require every 'discrete dispute[], . . . arising post-referral to satisfy Article III. Nor does any other provision.

(citations omitted.)

F. Entireties Property Can Be Administered to Pay One Spouse's Tax Debts to the IRS. *Morgan v. Bruton*, 99 F.4th 206 (4th Cir. 2024) (Hanes, J.).

The debtor filed for chapter 7 bankruptcy relief, claiming a tenancy-by-the-entirety exemption on a home he owned jointly with his non-debtor spouse. He also scheduled a significant tax debt to the IRS, for which his non-debtor spouse was not liable. The trustee objected to the exemption. Although entireties property normally can be administered only to pay a couple's joint debts, the trustee argued that this rule did not apply to debts owed to the IRS. The bankruptcy court, followed by the district court, sustained the trustee's objection.

On appeal, the Fourth Circuit first noted that § 522(b)(3)(B) exempts entireties interests where they are "exempt from process under applicable nonbankruptcy law," which includes both state and federal law. Applicable state law in North Carolina would exempt the house from non-joint debts, even to the IRS. However, the Supreme Court held in *United States v. Craft* that the federal government can impose a tax lien on entireties property, even where one spouse is not liable on the tax debt. 535 U.S. 274 (2002). Accordingly, because the home was not "exempt from process" under federal law, the court concluded that the debtor could not claim an entireties exemption against the IRS' tax lien.

G. Bartenwerfer Imputation of Fraud Applied to Alter Ego of Fraudster. Kahkeshani v. Hann (In re Hann), 72 Bankr. Ct. Dec. 244 (5th Cir. 2023) (per curiam).

In Bartenwerfer v. Buckley, 598 U.S. 69 (2023), the Supreme Court determined that, under § 523(a)(2)(A), debts created by a partner's fraud are nondischargeable against an innocent partner who did not act with fraudulent intent. Justice Sotomayor and Justice Jackson concurred in the judgment "[w]ith th[e] understanding" that the majority decision was applied only to debts "obtained by fraud of the debtor's agent or partner" and did not govern "a situation involving fraud by a person bearing no agency or partnership relationship to the debtor."

In this case, the creditor sought a determination that his arbitration award against the debtor was nondischargeable as a debt for "false pretenses, a false representation, or actual fraud" under § 523(a)(2)(A), and for "fraud or defalcation while acting in a fiduciary capacity" under § 523(a)(4). The only evidence the creditor submitted in support of nondischargeability was an arbitration award in which the arbitrator (1) found insufficient evidence that the debtor had personally made fraudulent representations, but (2) concluded the debtor was nonetheless liable for his company's fraudulent misrepresentations as an alter ego, and (3) determined the debtor was independently liable for violating the Texas Trust Fund Act. In the nondischargeability proceeding, the bankruptcy court imposed the limitation advanced by the Bartenwerfer concurrence, concluding in relevant part that "a debtor who did not personally make a false representation cannot be bound by the fraudulent actions or misrepresentations of another person unless the other person is the debtor's partner or agent." The district court disagreed, determining the debtor's debt was nondischargeable under § 523(a)(2)(A) and (a)(4).

Siding with the district court, the Fifth Circuit determined the debtor's debt was nondischargeable under § 523(a)(2)(A) and (a)(4). Importantly, the Fifth Circuit's decision supports the conclusion that § 523(a)(2)(A) applies to debts for fraud that a debtor did not personally commit—even if debtor is not the fraudster's partner or agent. Quoting *Bartenwerfer*, the Fifth Circuit explained that § 523(a)(2)(A)'s use of the passive voice places the court's focus on "how the money was obtained, not who committed fraud to obtain it." The Fifth Circuit did not discuss the *Bartenwerfer* concurrence. The debtor was liable under Texas law for a debt obtained by his business' fraudulent misrepresentations, so his debt was nondischargeable as a debt for "false representation" under § 523(a)(2)(A). The debt was also nondischargeable under § 523(a)(4) based on the debtor's misapplication of the creditor's funds in violation of the Texas Trust Fund Act. Consequently, the Fifth Circuit affirmed the judgment of the district court.

H. Exceptions to Discharge Under § 523(a) Apply to Corporate Subchapter V Debtors. Avion Funding, LLC. v. GFS Indus., L.L.C. (In re GFS Indus., L.L.C.), 99 F.4th 223 (5th Cir. 2024) (Duncan, J.).

In this case, the Fifth Circuit addressed whether the § 523(a) discharge exceptions apply to both corporate and individual Subchapter V debtors (as the Fourth Circuit has ruled) or only to individual debtors (as some bankruptcy courts have ruled). Identifying that the question is made complicated by "a certain textual awkwardness in the Bankruptcy Code," the court ultimately followed the Fourth Circuit's interpretation.

Debtor GFS Industries, LLC, entered into a pre-bankruptcy agreement with Avion Funding, LLC, which provided that Avion would give GFS \$190,000 in exchange for \$299,800 of GFS's future receivables. In executing the agreement, GFS represented it had not filed, nor did it anticipate filing, any chapter 11 bankruptcy petition. Yet, two weeks later, GFS filed under subchapter V. Avion filed an adversary complaint, alleging that GFS obtained Avion's financing through misrepresenting its anticipated bankruptcy filing. GFS argued, and the Bankruptcy Court agreed, that the applicable nondischargeability action applies only to individual and not corporate debtors, and Avion appealed.

The Fifth Circuit wrestled with the language of § 1192, which provides that after the debtor completes the required payments, the bankruptcy court shall grant "a discharge of all debts . . . except any debt . . . of the kind specified in section 523(a) of this title," and the preamble to § 523(a), which itself states that "[a] discharge... . does not discharge an individual debtor from any debt . . . ." The court identified that § 1192 governs discharge of debts of "a 'debtor,' plain and simple," and that it excepts from discharge "any debt . . . of the kind specified in Section 523(a)." Per the Fifth Circuit—and the Fourth Circuit in In re Cleary Packaging, LLC, 36 F.4th 509 (4th Cir. 2022)—"the most natural reading of § 1192(2) is that it subjects both corporate and individual Subchapter V debtors to the categories of debt discharge exceptions listed in § 523(a)." Further, as § 1192(2) is more specific than § 523(a), its provisions apply. The court further identified that the language of § 1192 mirrors language in § 1228(a), and courts have decided the discharge exceptions in § 1228(a) apply to both individual and corporate debtors. The court disagreed with arguments made by GFS that such a holding renders the word "individual" in § 523 superfluous and that such a holding goes against the policy purposes of subchapter V.

I. Section 363(m) Remains Waivable Post-MOAC, But No Party Waived It in This Case. Swiss Re Corp. Sols. Am. Insur. Co. v. Fieldwood Energy III, LLC (In re Fieldwood Energy, LLC), 93 F.4th 817 (5th Cir. 2024) (Southwick, J.).

Pre-petition, the debtors engaged in oil and gas exploration and production. Federal regulations impose costly "decommissioning obligations" on oil and gas companies who cease or reduce operations, requiring those companies "to take such measures as plugging wells, decommissioning pipelines, removing platforms, and clearing the seafloor of obstructions." "A key objective of the debtors' reorganization plan was to provide a means to satisfy their extensive decommissioning obligations." To fund these obligations, among other things, the debtors' confirmed plan sold assets and equity interests free and clear of creditors' claims and stripped subrogation rights of several sureties. The sureties opposed confirmation and appealed the confirmation order. They also sought, but failed to obtain, a stay of the confirmation order pending appeal from the bankruptcy court. On appeal, the district court concluded the sureties' appeal was moot under § 363(m) and Fifth Circuit authority.

The Fifth Circuit affirmed, concluding the appeal was statutorily moot under § 363(m) because the sureties did not obtain a stay pending appeal. Section 363(m) provides that a § 363 sale of property remains valid as to party who purchased in good faith despite reversal or modification on appeal, unless the sale order is stayed pending appeal. Thus, "[t]hat statutory section prohibits 'the appellate reversal of an order to sell property . . . unless such orders were stayed pending appeal." The Fifth Circuit rejected the sureties argument that MOAC Mall Holdings LLC v. Transform Holdco LLC, 598 U.S. 288 (2023)—in which the Supreme Court concluded § 363(m) is nonjurisdictional and waivable—narrowed § 363(m)'s limitation on appellate relief. MOAC merely "clarif[ied] that a party can lose the benefit of [§ 363(m)'s] terms." The district court "appropriately treated Section 363(m) as a nonjurisdictional precondition to relief that prevented the Sureties from succeeding on appeal." Next, that the sureties sought a stay pending appeal did not prevent the application of § 363(m). "The relevant question . . . is whether a stay was obtained." "There is no exception within the text [of § 363(m) for a party who seeks a stay and fails." The Fifth Circuit also rejected the sureties' argument "that Section 363(m) is inapplicable because the challenged provisions stripping them of subrogation rights were not integral to the sale of the Debtors' assets." Under Fifth Circuit precedent, a party may challenge a sale despite failing to obtain a stay if the "bankruptcy court specifically reserved an issue for later determination" that was integral to the sale. Here, the bankruptcy court did not reserve the issue of free and clear status for later determination. Instead, it explicitly found that sale would be "unlikely to close" unless it was free and clear of creditors' claims, relying on

sufficient supporting evidence and testimony. Thuse, the sureties' appeal was statutorily moot under § 363(m).

J. Confirmed Plan Bound Creditor with Actual Knowledge of Bankruptcy Case Despite Lack of Proper Notice. Raymond James & Assocs. Inc. v. Jalbert (In re German Pellets La., L.L.C.), 91 F.4th 802 (5th Cir. 2024) (Douglas, J.).

To raise capital for the construction of a manufacturing facility, the debtor sold bonds through a public financing authority. The creditor in this case purchased the bonds and re-sold them to third-party investors. As part of the creditor's purchase of the bonds, the debtor agreed to indemnify the creditor for any losses resulting from misleading or untrue statements of material fact in memoranda the debtor provided the creditor. The debtor's business failed, and the debtor filed a chapter 11 petition. The debtor did not serve the creditor with notice of its bankruptcy case or confirmed plan, but the creditor admitted it was aware of the bankruptcy case and monitored the docket. Under the terms of the debtor's confirmed plan, the debtor transferred its remaining assets and causes of action into a liquidating trust. The third-party investors who had purchased the bonds from the creditor assigned their claims against the creditor to the liquidating trust, and the liquidating trustee sued the creditor on the assigned claims under state securities laws. The creditor counterclaimed, arguing it was entitled to "compensation, recoupment[,] and setoff" premised on the debtor's agreement to indemnify it. The trustee returned to bankruptcy court, seeking a declaratory judgment. Among other things, the trustee argued the confirmed plan expressly freed the debtor from its pre-petition indemnification obligations, that the liquidating trust did not subsume the debtor's obligations (including the obligation to indemnify the creditor), and that liquidating trust was, therefore, "the wrong party against whom to raise [the debtor's] indemnity obligation." The creditor requested relief from the confirmation order under Rule 60(b), among other things. The bankruptcy court enforced the confirmation order, refused to attribute the debtor's indemnity obligations to the liquidating trust, and declined to amend the confirmation order. The district court affirmed.

The Fifth Circuit also affirmed. First, under Fifth Circuit precedent, the debtor's plan bound the creditor despite the creditor's lack of notice because the creditor had actual knowledge of the case. The debtor's indemnity obligation existed before the bankruptcy case, and the creditor should have acted to preserve its rights against the bankruptcy estate. Next, because the plan plainly prohibited setoff and recoupment against the debtor and its successors, it prevented the creditor from relying on the debtor's indemnification obligations in defending against the trustee's causes of action. The Fifth Circuit also determined the bankruptcy court did not err

in declining to modify the plan under Rule 60(b) due to the creditor's actual knowledge of the bankruptcy case and failure to participate. Finally, the Fifth Circuit rejected the creditor's remaining arguments because the debtor and the liquidating trust were distinct entities, and the creditor's arguments did not apply to the liquidating trust.

K. A Court Has Discretion to Deny an Amended Proof of Claim After Chapter 11 Plan Confirmation. CLO HoldCo, Ltd. v. Kirschner (In re Highland Cap. Mgmt. LP), 102 F.4th 286 (5th Cir. 2024) (Haynes, J.).

The debtor, an investment fund entity, was flooded with redemption requests during the 2008 financial crisis. After significant litigation and arbitration proceedings, the debtor eventually filed for chapter 11 bankruptcy relief. A creditor, claiming to have an interest in the fund's redemption claims, filed a timely proof of claim for \$11 million. However, the redemption requests were subsequently cancelled as part of a settlement between the debtor and a third party. Accordingly, the creditor amended its claim to an amount of zero. Thereafter, the debtor's plan was confirmed.

Eventually, the trustee pursued an adversary proceeding against the creditor and objected to its amended poof of claim. The creditor then filed a second amended proof of claim and a motion to ratify the claim, on the new theory that when the settlement between the debtor and the third party was executed, the creditor was owed the purchase price for the amount of the redemption claims. The bankruptcy court denied the motion to ratify, which was affirmed by the district court.

On appeal to the Fifth Circuit, the creditor argued that the bankruptcy court abused its discretion by failing to apply the two-factor test of *In re Kolstad*, 928 F.2d 171 (5th Cir. 1991). In *Kolstad*, the court provided that upon analyzing an amendment to a proof of claim, a court may consider: (1) whether the amendment strays from the original proof of claim such that it "could not have been foreseen from the earlier claim or events"; and (2) whether the amendment would cause prejudice.

The Fifth Circuit disagreed. First, it distinguished *Kolstad* from the case at hand, as *Kolstad* did not involve a proof of claim that was filed *after* plan confirmation where a "heightened showing" is required. Second, the court did not read *Kolstad* as requiring an exclusive two-factor test. Indeed, bankruptcy courts, given their equitable nature, may weigh various considerations. Given the creditor's year-long delay, the bankruptcy court did not abuse its discretion in denying the motion to ratify the second amended proof of claim.

L. Bankruptcy Court Cannot Approve Partial Assignment of Executory Contract. Anytime Fitness, L.L.C. v. Thornhill Bros. Fitness, LLC (In re Thornhill Bros. Fitness, L.L.C.), 85 F.4th 321 (5th Cir. 2023) (per curiam).

As part of a settlement with a creditor, the debtor assigned to a third-party creditor under § 365(f) any rights it had against its franchisor under its franchise agreement. The creditor then sued the franchisor in state court, and the franchisor sought to have the assignment reversed. The bankruptcy court entered a new order ratifying its prior approval of the settlement agreement but was reversed by the Fifth Circuit in a per curiam opinion.

The Fifth Circuit only addressed the franchisor's argument that the assignment was improper because it was an impermissible partial assignment of an executory contract under § 365(f). The court held that the debtor cannot partially assign an executory contract because § 365(f) requires the debtor to assume and assign the executory contract in full. The Fifth Circuit focused on the text of § 365(f) which refers to "an executory contract," and "such contract" suggesting that assumption and rejection occur with respect to the entire agreement. The Fifth Circuit reasoned that if a debtor could strategically divide its executory contracts via assignments, the debtor could effectively change the nature of its contractual obligations while retaining certain benefits. The court also concluded that this result was consistent with other subsections of § 365 which suggests that the debtor's contractual counterparty should retain the rights it would have outside of bankruptcy when a debtor rejects and therefore breaches its contract.

M. Res Judicata Did Not Bar Modification to the Automatic Stay After the Court Denied Previous Modification. Am. Warrior, Inc. v. Found. Energy Fund IV-A, L.P. (In re McConathy), 111 F.4th 574 (5th Cir. 2024) (Jones, J.).

The facts of this case are robust and complicated. In short, the debtors filed bankruptcy in Louisiana in 1990, but they failed to disclose oil and gas interests in 3,000 acres of land in Kansas. More than 30 years later, in 2021, discovery in a Kansas state court action revealed the debtors' failure to disclose their oil and gas interests in bankruptcy. AWI, a defendant in the Kansas state court action, moved to reopen the debtors' bankruptcy case. The chapter 7 trustee then successfully moved to stay the Kansas litigation as an action involving property of the estate under § 362. A couple of parties to the Kansas litigation sought to modify the stay to proceed with the litigation in state court. The bankruptcy court declined to modify the stay at that juncture because the state court action was intertwined with claims of the estate. But after the trustee resolved the lingering issues concerning property of the estate, the bankruptcy court then modified the stay and abstained to allow

the Kansas litigation to continue. AWI appealed the bankruptcy court's modification of the stay and its abstention from entertaining the Kansas litigation issues.

AWI argued that the Kansas litigation was void ab initio because of the automatic stay and the debtors' failure to disclose their oil and gas interests during their bankruptcy. AWI challenged the modification of the stay, arguing that res judicata barred the subsequent modification because the bankruptcy court had previously denied a request to modify the stay. AWI also argued that the bankruptcy court could not abstain from deciding the Kansas litigation issues.

Judge Jones, writing for the Fifth Circuit, rejected AWI's argument that the Kansas litigation was void ab initio. Judge Jones reiterated that the bankruptcy court only temporarily stayed the Kansas litigation to protect potential property of the estate. After the chapter 7 trustee settled property claims, the bankruptcy court concluded that there was no need to continue to stay the Kansas litigation. Addressing AWI's res judicata argument, Judge Jones accused AWI of conflating two forms of "finality"—finality in terms of appealability and finality in terms of res judicata. Distinguishing this case from the Supreme Court's decisions in Ritzen and Travelers, Judge Jones explained that Ritzen only establishes that stay relief motions are discreet proceedings that lead to appealable orders, and Travelers had nothing to do with appealability of stay relief orders. Critically, Judge Jones reasoned that "[t]he Bankruptcy Code is not a straitjacket" and "new facts or circumstances may [] warrant an order modifying or lifting a bankruptcy automatic stay" even if the bankruptcy court previously denied a request for modification. Lastly, Judge Jones rejected AWI's appeal of the bankruptcy court's abstention order because 28 U.S.C. § 1334(c) limits the court of appeals' review a bankruptcy court's application of permissive abstention.

N. Rule 60(b)(4) Motion Subject to Reasonable Timeliness Requirement. Vista-Pro Auto., LLC v. Coney Island Auto Parts Unlimited, Inc. (In re Vista-Pro Auto., LLC), 109 F.4th 438 (6th Cir. 2024) (Larsen, J.).

Debtor Vista Pro filed an adversary proceeding against Coney Island Auto Parts, seeking recovery of \$50,000 in unpaid invoices. The summons and complaint were addressed to Coney Island Auto Parts' business address, not a corporate officer or individual, because the corporation itself was listed as the registered agent according to New York State Department records. After the debtor received no response, the debtor sought a default judgment. After notice of the impending default was sent to the same address with no response, the court entered default judgment. The court subsequently converted the case to chapter 7, and a trustee began attempting to collect on the default judgment. The trustee identified Coney Island Auto Parts' CEO and sent him a letter in April 2016 notifying him of the

default judgment. The CEO admitted he received the letter but did not respond to the trustee. For several years, the trustee attempted to collect the default judgment until in October 2021, Coney Island Auto Parts moved to have the default judgment vacated by the bankruptcy court for the Southern District of New York. The court, however, denied the motion, deciding that Coney Island Auto Parts needed to seek relief in the Middle District of Tennessee—where Vista Pro's bankruptcy was filed. In July 2022, Coney Island Auto Parts filed a Rule 60(b)(4) motion in the Middle District of Tennessee bankruptcy court to have the default judgment vacated for lack of personal jurisdiction. The bankruptcy court denied the motion, determining that the motion was not filed within a reasonable time. Coney Island Auto Parts appealed to the district court which affirmed the bankruptcy court. Coney Island Auto Parts then appealed to the Sixth Circuit Court of Appeals.

The Sixth Circuit held that Rule 60(b)(4) requires the movant to file its motion to set aside a judgment within a reasonable amount of time after being provided with actual notice of the judgment. Judge Larsen, writing for the majority of the panel, recognized that the Sixth Circuit approach was the minority view but decided that the "reasonable time" requirement was consistent with the plain text of Rule 60(b)(4) and equitable principles. Specifically, the majority relied on the text of Rule 60(c)(1) which says that all Rule 60(b) motions must be filed within a reasonable time. The court concluded that the several-year delay in this case was unreasonable. Addressing Coney Island Auto Parts' due process argument, Judge Larsen noted that any due process concerns can be dealt with when the court considers whether a reasonable amount of time has elapsed. Here, the trustee provided actual notice by mailing the CEO of Coney Island Auto Parts, but Coney Island Auto Parts waited years before attempting to vacate the judgment.

Judge McKeague, dissenting, argued that courts have no authority to enforce void judgments. He said he would vacate the bankruptcy court holding that the motion was untimely and would remand for the bankruptcy court to determine whether the judgment was void.

O. A Debtor Cannot Recover Attorneys' Fees Under the Equal Access to Justice Act for Opposing a U.S. Trustee's Motion to Dismiss. *Teter v. Baumgart (In re Teter)*, 90 F.4th 493 (6th Cir. 2024) (Readler, J.).

The debtor filed for chapter 7 bankruptcy, describing certain loans as primarily business debts. The United States Trustee filed a motion to dismiss the case for abuse under § 707(b), arguing that the debts were primarily consumer debts. After the trustee withdrew the motion, the debtor sought attorneys' fees under the Equal Access to Justice Act (the "EAJA"). The bankruptcy court denied that request, as did the district court.

On appeal to the Sixth Circuit, the court first addressed the bankruptcy court's jurisdiction to hear the EAJA issue. The court noted that there is a split of authority as to whether EAJA issues are core or non-core proceedings. However, it did not matter under these circumstances. If EAJA proceedings are core, the bankruptcy court certainly had jurisdiction. And if the proceedings were non-core, the bankruptcy court still had jurisdiction because the parties had consented to the court's jurisdiction by litigating the issue.

Having determined that the bankruptcy court had jurisdiction, the court then turned to the merits of the debtor's request for attorneys' fees. The EAJA permits fees and costs incurred in a "civil action." By using interpretive tools such as the Federal Rules of Civil Procedure and Black's Law Dictionary, the court determined that a simple motion to dismiss in a bankruptcy proceeding alone cannot constitute a "civil action." Furthermore, § 707(b)(5)(A) appears to govern at least some provision for attorneys' fees in bankruptcy, perhaps suggesting that the EAJA does not apply to bankruptcy proceedings at all. Accordingly, the Sixth Circuit affirmed.

# P. Sixth Circuit Declines to Apply Judicial Estoppel to Unscheduled Action Seeking Equitable Relief. *McGruder v. Metro. Gov't*, 99 F.4th 336 (6th Cir. 2024) (Clay, J.).

The chapter 7 debtor in this case failed to schedule a Title VII retaliation cause of action that was pending in district court on the petition date. After the debtor received her discharge, the district court awarded her monetary damages and the equitable remedy of reinstatement with her former employer. While the creditor's appeal of the district court judgment against it was pending, the creditor asked the court to revise the district court judgment, arguing the court should invoke judicial estoppel to dismiss the district court case due to the debtor's failure to disclose the cause of action in bankruptcy. The district court determined the creditor's pending appeal deprived it of jurisdiction over the case but stayed the reinstatement order pending appeal.

The Sixth Circuit first determined it lacked jurisdiction to consider the appeals of all orders except the order requiring reinstatement because the district court's orders were not yet final. The court, however, had jurisdiction to consider the reinstatement order because it fell within a statutory exception to the statutory rule against appellate jurisdiction over interlocutory orders, § 1292(a)(1), which permits appellate jurisdiction over interlocutory orders granting injunctive relief. Next, the Sixth Circuit declined to judicially estop the reinstatement order. "Judicial Estoppel need not be applied to claims of equitable relief not disclosed in prior bankruptcy proceedings" because estopping such claims "would not serve the goals of the doctrine." Because the claim for reinstatement would not have materially altered the chapter 7 bankruptcy proceedings or produced additional assets for the

estate, the debtor's failure to disclose the action did not justify judicial estoppel of the reinstatement order. After further upholding the reinstatement order on the merits, the Sixth Circuit affirmed that order and otherwise dismissed the appeal for lack of jurisdiction.

Q. A Chapter 13 Trustee May Not Collect a Percentage Fee in a Case Dismissed Prior to Confirmation. *Marshall v. Johnson*, 100 F.4th 914 (7th Cir. 2024) (Kirsch, J.).

Debtor Edward Johnson filed a voluntary petition under chapter 13. While his bankruptcy case was pending, he made about \$3,800 worth of payments to the bankruptcy trustee under his proposed repayment plan. The trustee distributed approximately \$750 in pre-confirmation adequate protection payments and retained the rest for distribution upon plan confirmation. Eventually, the case was dismissed for unreasonable delay, with no plan ever having been confirmed. Before returning the undisbursed payments to the debtor, the trustee deducted a percentage fee of around \$260 as compensation under 28 U.S.C. § 586(e)(2) and 11 U.S.C. § 1326(b). The debtor sought disgorgement of the trustee's retained compensation and the Bankruptcy Court granted the motion on the basis that the trustee did not have statutory authority to retain such compensation.

The Seventh Circuit affirmed the decision below and required the trustee to disgorge the retained fees. First, the court noted that § 1326(a)(2) requires a trustee to return unpaid and not-yet-due payments to the debtor, after deducting any unpaid claim allowed by § 503(b). Citing the Ninth and Tenth Circuits, the court agreed that the trustee's fee did not fall within either of the § 1326(a)(2) exceptions. Second, the court held that the trustee's § 1326(b) argument—that she was authorized to keep a fee when making pre-confirmation adequate protection payments to creditors—was unconvincing, because § 1326(b) addresses only payments made after a plan has been confirmed. Further, § 1326(b) applies only to payments made "under the plan," and pre-confirmation adequate protection payments are not made "under the plan," but rather are owed under an "order for relief." The court then applied the same logic to the trustee's argument that fees were warranted under 28 U.S.C. § 586(e)(2), because that section also only applies to payments made "under plans," and clarified that § 586(e)(2) was irrelevant anyway because it only addressed the source of funds to be used and did not establish an irrevocable right to be paid. Finally, the court compared the language of § 1326 to statutory provisions for other chapters that include explicit language permitting the trustee to deduct fees before returning undisbursed funds.

R. Section 505 Does Not Give Bankruptcy Courts Jurisdiction to Determine Tax Obligations, but § 1334 May. Bush v. United States, 100 F.4th 807 (7th Cir. 2024) (Easterbrook, J.).

The question presented was whether a bankruptcy court can determine the amount of a debtor's tax obligations when the debtor is unlikely to pay them. The Bankruptcy Court said "yes." The Seventh Circuit first issued its opinion in this case in 2019, after the case had been under submission for more than two years, and remanded it to the district court with instructions to send the dispute to the Tax Court. The parties petitioned for rehearing and rehearing en banc. The court took more than four years to resolve those petitions.

In 2013, the IRS demanded that debtors Donald Wayne Bush and Kimberly Ann Bush pay approximately \$107,000 in taxes, plus \$80,000 in fraud penalties, for tax years 2009-2011. The debtors petitioned the Tax Court for review but then filed for bankruptcy in 2014, on the date set for trial. The bankruptcy court declined to lift the stay. The United States did not appeal but did file a proof of claim seeking taxes and penalties and proposed that the tax debt be given priority over the debtors' other unsecured debts, while the penalty (whatever its ultimate amount) be determined to be nondischargeable under § 523(a)(7). The debtors then initiated an adversary proceeding, asking the bankruptcy court to set the penalty at 20% of their unpaid taxes.

The debtors argued that § 505 supplies jurisdiction to bankruptcy courts, while the United States argued § 505 as a whole does not grant subject-matter jurisdiction to bankruptcy judges and that only a potential effect on creditors' distributions justifies a decision by a bankruptcy judge about any tax dispute.

The Seventh Circuit disagreed that § 505 has anything to do with jurisdiction; rather, it merely "sets out a task for bankruptcy judges," just like the rest of the Bankruptcy Code. Jurisdiction under 28 U.S.C. § 1334—the statute relied upon by the debtors—is limited to disputes "arising in" bankruptcy litigation, those "arising under" the Bankruptcy Code, and those "related to" the resolution of the bankruptcy proceeding. Determination of tax debt and penalties is not exclusive to bankruptcy, nor does it stem from the Bankruptcy Code, so it does not arise in or under Title 11. Determining whether it is "related to" the resolution of the bankruptcy is a much more difficult question dependent upon an *ex ante* review of whether the disposition of the § 505 dispute would affect other creditors' entitlements.

The Court remanded to the District Court with instructions (1) to determine whether the related-to jurisdiction applies in light of the analysis in its opinion and (2), if it does, to decide whether to abstain under 28 U.S.C. § 1334(c).

S. Section 546(e) Safe Harbor Applies to Transactions in Connection with Privately Held Securities. *Petr v. BMO Harris Bank N.A.*, 95 F.4th 1090 (7th Cir. 2024) (St. Eve, J.).

Pre-petition, the debtor was a privately held company whose stock was in an Employee Stock Ownership Plan Trust. Also pre-petition, a purchaser acquired the debtor by purchasing all of its stock, financing the transaction by personally guaranteeing a loan from BMO Harris Bank. The debtor was not liable under the purchaser's loan. Soon after the purchaser obtained control of the debtor, the purchaser caused the debtor to incur a separate debt to pay off the purchaser's loan to BMO Harris, effectively making the debtor liable for the costs of acquisition and relieving the purchaser from its own liability. The debtor received no value for this transfer. Post-petition, the chapter 7 trustee brought an adversary proceeding to avoid the debtor's transfer paying off the creditor's loan to BMO as constructively fraudulent and recover the value of the transfer from BMO or the purchaser under §§ 544 and 550, as well as the Indiana Uniform Voidable Transactions Act. The defendants moved for dismissal, arguing § 546(e)—which protects defendants against avoidance of transfers to financial institutions in connection with a securities contract—applied because the overarching transaction was one for the purchase of the debtor's stock. The bankruptcy court denied the motion to dismiss. The district court reversed, directing the bankruptcy court to dismiss the trustee's adversary complaint.

Siding with the district court, the Seventh Circuit concluded that the § 546(e) safe harbor applied and shielded the defendants from fraudulent transfer liability. Seventh Circuit rejected the trustee's argument that the safe harbor only shielded transactions that implicate publicly held securities. The safe harbor applies to privately held securities because "nothing in the plain language of § 546(e)" and the associated "broad[]" definition of the term "securities contract" (which is defined to include stock) "excludes private contracts not implicating the national securities clearance system." The stock purchase agreement was clearly a securities contract. As to the purchaser's guarantee of the BMO loan, the loan itself was clearly "any extension of credit for the clearance or settlement of securities transactions" that fell within the definition of the terms "securities contract" under § 741(7)(A)(v), and the purchaser's guarantee was either a "credit enhancement related to" the loan within the meaning of § 741(7)(A)(xi) or was "similar to" that form of securities contract so as to fall within the "catch all sub-definition" of a securities contract in § 741(7)(A)(vii). The transfer itself was "in connection with" a securities contract under § 546(e) because the transfer satisfied a securities contract and the associated guarantee (itself a securities contract) effectuated the stock purchase agreement (also a securities contract). The one-month delay between the stock purchase and the transfer did not "break the connection between the transfer and the [stock

purchase]." Thus, § 546(e)'s safe harbor applied and shielded the transfer. The Seventh Circuit also rejected the trustee's argument (made for the first time on appeal) that "even if § 546(e)'s safe harbor precludes his claims to avoid the [t]ransfer," because the Indiana statute permitted recovery to the extent a transfer was voidable under that law, and the transfer would have been voidable under Indiana law, the Indiana statute permitted him to recover the transfer as "voidable" without actually avoiding it. The court reasoned that § 546(e)'s safe harbor preempted the trustee's ability to recover the value of the transfer under the Holding otherwise would render the safe harbor Indiana avoidance statute. meaningless and frustrate its purpose. Indeed, recovery under § 550 requires that "the transfer [be] avoided under § 544" (not voidable under state law), and "[a]llowing the trustee to obtain the part and not the parcel by dressing up his claim as an [Indiana avoidance] claim brought under § 544(a) poses an insurmountable obstacle to the safe harbor—an obstacle that the doctrine of conflict preemption does not permit." Thus, "the district court did not err in directing the bankruptcy court to dismiss the Trustee's complaint with prejudice."

T. A State that Files an Unsuccessful Involuntary Petition Against a Debtor Does Not Waive Sovereign Immunity in a Related § 303(i) Action Brought by the Debtor, Absent Further Unequivocal Waiver of Immunity. *Mont. Dep't of Revenue v. Blixseth (In re Blixseth)*, 112 F.4th 837 (9th Cir. 2024) (Rawlinson, J.).

The Montana Department of Revenue, Idaho State Tax Commission, and California Franchise Tax Board filed an involuntary bankruptcy petition against debtor Timothy Blixseth for unpaid taxes following an audit of him and his business entities. The Idaho and California agencies settled with the debtor and withdrew as petitioning creditors. The debtor filed a motion for summary judgment seeking dismissal of the involuntary petition, and the bankruptcy court ruled in favor of the debtor, holding that, "because the State's claim was the subject of a bona fide dispute as to the amount of liability," the State could not serve as a petitioning creditor, and the petition could not be sustained based on the existence of only one other remaining petitioning creditor (the Yellowstone Liquidating Trust, which joined the petition after the three state entities). The State appealed to the district court, which affirmed, and again to the Ninth Circuit, which also affirmed. On remand, the bankruptcy court dismissed the involuntary petition for want of prosecution.

The debtor then filed an adversary proceeding against the State under § 303(i), seeking attorneys' fees and costs, related damages, and sanctions against counsel. The State, in turn, moved to dismiss the proceeding asserting sovereign immunity. The bankruptcy court concluded that the State was not immune from liability because (1) it had voluntarily invoked the bankruptcy court's jurisdiction by filing

the petition, (2) the State's counsel had clearly and unequivocally waived sovereign immunity on the record, and (3) an action under § 303(i) is ancillary to the bankruptcy court's *in rem* jurisdiction and that, to accept the State's argument would be to impermissibly read § 106(a)(1) out of the Bankruptcy Code. The State appealed, and the BAP dismissed the appeal on the ground that the order was not appealable. The State then appealed to the Ninth Circuit. The Ninth Circuit overturned the BAP, noting that the Supreme Court and previous decisions of the Ninth Circuit have "concluded that denials of sovereign immunity are immediately appealable under the collateral order doctrine." As to the bankruptcy court's findings, the Ninth Circuit disagreed.

First, the panel found that the State did not voluntarily invoke the jurisdiction of the bankruptcy court. The Panel noted that while a voluntary invocation of the bankruptcy court's jurisdiction occurs with the submission of a proof of claim, the State never filed a proof of claim. So, any litigation waiver must instead be predicated upon the existence of a claim arising out of the proceeding brought by the State. The court was not persuaded that a § 303(i) claim was the equivalent of a compulsory counterclaim when an involuntary petition is filed under § 303(b), because "a claim filed under § 303(i) cannot arise out of the same factual predicate that supports a § 303(b) claim." The panel held that a "§ 303(i) claim arises from the fact of the filing of an involuntary petition under § 303(b), and therefore cannot satisfy the logical relationship test as a matter of law." And on a factual basis, the States' involuntary petition alleged a debt of unpaid taxes from an improper tax deduction, whereas the § 303(i) claim was based on the consequences of having to defend against the petition and *not* claims arising from his alleged tax deficiency. Thus, the § 303(i) claim would fail the logical relationship test. The court also concluded that § 303(i) is unlike sanctions imposed under Rule 11; § 303(i) is merely a fee-shifting provision that turns on the merits of the litigation as a whole.

Second, despite the discussion of sovereign immunity by the State's counsel at the bankruptcy court's hearing, such statements did not constitute an "unequivocal" waiver of sovereign immunity. Citing *United States v. Nordic Village, Inc.*, 503 U.S. 30 (1992), the panel noted that "the 'unequivocal expression' of elimination of sovereign immunity that the Supreme Court insists upon is an expression in statutory text..." (cleaned up), which the State's counsel "could not" and "did not" do.

Third, the panel pointed out that the Ninth Circuit previously recognized § 106(a)—which states "sovereign immunity is abrogated as to a governmental unit to the extent set forth within this section with respect to . . . [Section] 303 . . ."—as an unconstitutional assertion of Congress's power. So, the court shifted its analysis to the role of *Central Virginia Community College v. Katz*, 546 U.S. 356 (2006), in determining whether the State was entitled to sovereign immunity. *Katz* identified that the states acquiesced to the bankruptcy courts' jurisdiction to the extent it

furthered three critical functions: "[1] the exercise of exclusive jurisdiction over all of the debtor's property, [2] the equitable distribution of that property among the debtor's creditors, and [3] the ultimate discharge that gives the debtor a 'fresh start' by releasing him, or her, or it from further liability for old debts." Referring to those functions, the panel determined that the adversary proceeding did not qualify as a proceeding necessary to effectuate the *in rem* jurisdiction of the bankruptcy courts. The court determined that § 303(i) establishes a remedial cost-shifting scheme that is not at all similar to the first two functions identified by *Katz*. The panel then determined that § 303(i) does not even concern property in the *res* of the estate and does nothing to further the debtor's obtaining of a fresh start through discharge. Thus, the Ninth Circuit held that the State's assertion of sovereign immunity under the Eleventh Amendment was properly invoked. Accordingly, the panel reversed the bankruptcy court's denial of sovereign immunity and remanded with instructions to dismiss the debtor's § 303(i) claim against the state.

Note: Judge Michael Melloy of the Eighth Circuit, a former bankruptcy judge, sat by designation with the Ninth Circuit in this case.

U. Failure to Properly Schedule Creditor Renders Entire Debt Nondischargeable. *Licup v. Jefferson Ave. Temecula LLC (In re Licup)*, 95 F.4th 1234 (9th Cir. 2024) (Thomas, J.).

The debtors scheduled their debt to a judgment creditor but listed an incorrect mailing address. After the case was closed and the debtors received their general discharge, the judgment creditor sought a determination that the debtor's entire debt to it was nondischargeable. The debtors asked the court to limit the nondischargeable portion to the amount the judgment creditor would have received if it had filed a proof of claim against the estate (a small percentage of the total claim amount). The bankruptcy court determined the entire debt was nondischargeable, and the Ninth Circuit BAP agreed. The Ninth Circuit affirmed. Under Rule 1007 of the Federal Rules of Bankruptcy Procedure, § 523(a)(3)(A), and relevant case law, debts are discharged only if the debtor properly schedules the creditor's name and address in time for the creditor to file a proof of claim. That unscheduled debts may be discharged in no-asset cases does not undermine this mandate; because "the bankruptcy rules do not require creditors to any file claims [in no asset cases], as there are no assets to distribute," § 523(a)(3)(A)'s prohibition against discharge of unscheduled debts does not apply in those cases. Any windfall the creditor in this case might receive as a result of its ability to collect its entire debt rather than the portion that it would have received if it had filed a proof of claim was "of no moment." Here § 523(a)(3)(A) applied and expressly prohibited discharge of the entire debt.

V. Debtor's Claim Against Employer for Discriminatory Acts Starting Pre-Petition and Continuing Post-Petition Was Property of the Estate. *Bercy v. Phoenix*, 103 F.4th 591 (9th Cir. 2024) (Johnstone, J.).

The debtor worked for the city of Phoenix and had a claim against the city for workplace harassment and racial discrimination. She reported the conduct twice before she filed a chapter 7 bankruptcy petition. She knew that she had a claim against her employer when she filed her bankruptcy but did not identify the claim on her petition. The harassment continued during her bankruptcy. She received a discharge, and later sued the city in district court. When the city learned of her bankruptcy, they sought dismissal of the lawsuit, alleging the debtor lacked standing because the claim was property of the estate. After the trustee learned of the case against the city, the trustee successfully moved to reopen the bankruptcy case. The trustee settled the case with the city, and the district court dismissed the case after concluding that the debtor lacked standing. She appealed to the Ninth Circuit.

Section 541(a)(1) provides that a claim belonging to the debtor when she files bankruptcy becomes property of the estate. And only the trustee has capacity to sue on the estate's behalf. But here, the conduct continued post-petition. Judge Johnston, writing for the Ninth Circuit, said that the debtor's claim against her employer accrued prepetition and, therefore, was property of the estate. Judge Johnstone focused on the claim itself, brought under Title VII of the Civil Rights Act, which does not "separate individual acts that are part of the hostile environment claim from the whole for the purpose of timely filing and liability." Thus, even though the conduct started pre-petition and continued post-petition, the claim accrued pre-petition, and only the trustee retained standing to bring the claim.

W. Despite Lack of Objection, Debtors Could Not Exempt More than Statutory Homestead Exemption Amount. *Munding v. Masingale* (In re Masingale), 108 F.4th 1195 (9th Cir. 2024) (Bress, J.).

Reversing a decision of the BAP and remanding, the Ninth Circuit held that, under the circumstances of this case, a chapter 7 debtor could not exempt from the bankruptcy estate a homestead interest in her residence in an amount above the statutory limit.

In this case, the debtors filed a chapter 11 bankruptcy petition and represented on a bankruptcy schedule that they were exempting "100% of FMV" in their homestead. But "the maximum homestead exemption the [debtors] could claim under federal

law at the time their petition was filed was \$45,950." No party objected within the 30-day period.

Distinguishing Taylor v. Freeland & Kronz, 503 U.S. 638 (1992), and Schwab v. Reilly, 560 U.S. 770 (2010), the Ninth Circuit held that, under the circumstances presented in this case, the fact that no party initially objected did not mean that the debtor could exempt more than the statutory limit. Because the case began as a chapter 11 case, in which the debtors owed fiduciary duties to their creditors, and in light of specific and conflicting representations that the debtors made within the 30-day objection window, the debtors did not properly claim an above-limit exemption. As a result, no early objection to the homestead exemption was required. The Ninth Circuit held that the homestead exemption was limited to the statutory cap, and the remaining proceeds from the sale of the home were part of the bankruptcy estate.

X. A Debtor Need Not Use Real Property Exclusively as a Principal Residence for the Anti-Modification Provision of § 1123(b)(5) to Apply. Lee v. U.S. Bank Nat'l Ass'n, 102 F.4th 1177 (11th Cir. 2024) (Luck, J.).

The debtor mortgaged her real property with a bank. She used most of the real property as her residence, but she leased the rest to a third party to farm.

The debtor eventually filed for chapter 11 bankruptcy relief and filed a reorganization plan that modified the bank's claim regarding the real property. The bank sought relief from the stay, arguing that the debtor's plan could not be confirmed because it improperly modified its claim. Although most secured claims can be modified through a plan of reorganization, § 1123(b)(5) provides that a creditor's claim cannot be modified if that claim is "secured only by a security interest in the real property that is the debtor's principal residence." In response, the debtor argued that she was not prevented from modifying the bank's claim because she did not use the real property exclusively as her principal residence, but also for farming. The bankruptcy court disagreed and granted stay relief. The district court affirmed on appeal.

The Eleventh Circuit addressed the following question: does the language "secured only by a security interest in the real property that *is* the debtor's principal residence," require the debtor to use the property *exclusively* as her principal residence? The court concluded no, resting its decision entirely on an interpretation of the word "is" within § 1123(b)(5).

The court began with the text of the statute. A plain meaning approach to the relevant language would not lead the average person to believe the property can only be the debtor's principal residence. Furthermore, dictionary definitions at the time of the anti-modification provision's enactment did not define "is" as meaning

"exclusively." In short, while "is" operates to equate the property with being a debtor's principal residence, it does not require that the property is *only* the debtor's principal residence. Accordingly, the court of appeals affirmed.

Judge William Pryor dissented, first noting that within the English language, there is both a "descriptive" and an "equivalent" usage of the word "is." The surrounding statutory language, as well as the definition of a "debtor's principal residence" under § 101(13A)(A), makes clear that § 1123(b)(5) uses the "is" of equivalence. Accordingly, the dissent would have concluded that the anti-modification provision only applies to debtors who use property exclusively as their principal residence.

Y. A Court May Recognize a Foreign Proceeding Under Chapter 15 Even if the Subject of the Proceeding Is Not Eligible to Be a Debtor Under Section 109(a). Al Zawawi v. Diss (In re Al Zawawi), 97 F.4th 1244 (11th Cir. 2024) (Lagoa, J.).

The major issue presented in this case is whether § 109(a) applies to cases brought under chapter 15 of the Bankruptcy Code. As the Court stated, the plain text of the Bankruptcy Code indicates "yes." However, the Court did not stop its analysis there, and actually determined that § 109(a) did *not* apply.

Al Zawawi, the appellant, owned shares in QAPA Investing Corporation NV, an entity incorporated in Curacao that wholly owned several Florida entities. Those Florida entities collectively owned around \$94 million worth of real estate in Florida. In 2015, Al Zawawi moved to the U.K. with his wife. His wife petitioned for dissolution, and he disclosed ownership of assets in the U.S. His wife obtained a divorce and judgment for 24 million pounds from a U.K. court, and the U.K. court then issued a worldwide freeze against Al Zawawi, enjoining him from disposing of any of his assets until the judgment is paid in full. After he failed to make payments on the judgment, Al Zawawi's ex-wife petitioned the U.K. court to place Al Zawawi in involuntary bankruptcy. Al Zawawi was adjudged bankrupt and, soon after, Colin Diss, Hannah Davie, and Michael Leeds (collectively, the "Foreign Representatives") were appointed joint trustees in connection with the case. The Foreign Representatives then began this case by filing a Chapter 15 Petition for Recognition of a Foreign Proceeding in the U.S. Bankruptcy Court for the Middle District of Florida.

The Foreign Representatives requested recognition of a foreign proceeding and argued that the requirements of § 1517 were satisfied. Al Zawawi did not dispute that, but argued instead that § 109(a) was not satisfied, so the case should be dismissed. The bankruptcy court granted the petition for recognition and, in doing so, determined that § 109(a) does not apply to chapter 15 cases. The District Court affirmed, and Al Zawawi timely appealed to the Eleventh Circuit.

The court recognized that a plain reading of § 103(a) clearly indicates that § 109(a) applies to chapter 15. However, because of prior precedent in the Eleventh Circuit holding that chapter 1's debtor-eligibility language did not apply to cases ancillary to foreign proceedings under former Section 304—In re Goerg, 844 F.3d 1562 (11th Cir. 1988)—the court was "bound" to follow that precedent. In Goerg, pointing to tension between § 101's definition of "debtor" and "foreign proceeding," the court determined that "it would make little sense to require that the subject of the foreign proceeding qualify as a debtor under United States bankruptcy law,' and that instead it 'would make eminent sense for Congress to define expansively the class of foreign insolvency proceedings for which ancillary assistance is available." Finding that same logic to apply in this case despite statutory differences, the Court held that "based on the definition of 'foreign proceeding' in § 101(12), as informed by the purpose of Chapter 15, debtor eligibility under Chapter 1 is not a prerequisite for the recognition of a foreign proceeding under Chapter 15."

Z. Denial of an Exemption in a State-Court Collection Action Did Not Prevent the Debtor from Exempting Property in Bankruptcy. *Ala. Creditors v. Dorand (In re Dorand)*, 95 F.4th 1355 (11th Cir. 2024) (Pryor, J.).

Prior to the debtor's bankruptcy filing, the creditor obtained a default judgment against the debtor for \$1.6 million. The creditor sought to collect, and a state court issued a writ of garnishment against the debtor's IRA held by Morgan Stanley. The debtor attempted to fight off the collection action, arguing that his retirement funds were exempt under Alabama law. The state court disagreed and entered a judgment accordingly. Before Morgan Stanley could transfer the liquidated retirement funds to the creditor, the debtor filed a chapter 7 bankruptcy petition. The debtor claimed his retirement funds were exempt, and the creditor objected.

The bankruptcy court concluded that the retirement account was the debtor's estate property and that the state court decision did not prevent the debtor from claiming an exemption. The creditor then appealed to the Eleventh Circuit. On appeal, the court addressed four issues: (1) whether the *Rooker-Feldman* doctrine limited the bankruptcy court's jurisdiction; (2) whether the retirement account was estate property; (3) whether Morgan Stanley had a right to setoff; and whether (4) the debtor was collaterally estopped from claiming an exemption that was denied by the state court judgment.

First, the court determined that the *Rooker-Feldman* doctrine did not apply to the facts of this case. Neither party asked the bankruptcy court to overturn or alter the state-court judgment—they merely sought clarification as to the effect of the judgment on the debtor's claimed exemption. Second, after analyzing Alabama law, the court determined that the debtor still had an interest in the retirement account

despite the state court's decision. Therefore, the retirement account remained property of the estate.

Third, the court determined that judgment did not create a right to setoff. Although Morgan Stanely owed a debt to the debtor merely by administering a deposit account in favor of the debtor, the debtor owed no debt to Morgan Stanley. Finally, collateral estoppel did not apply, as it was unclear whether the exemption issue was a "necessary" part of the state court judgment. Under Eleventh Circuit precedent, when the grounds on which a state court rests its decision are unclear, collateral estoppel cannot apply.

# AA. Concurrence: Though Binding, Precedents Mischaracterize Lack of Authority to Assert a Cause of Action as Lack of Prudential Standing. *Wiand v. ATC Brokers LTD.*, 96 F.4th 1303 (11th Cir. 2024) (Pryor, J.).

A receiver appointed to recover assets for investors who fell victim to a Ponzi scheme asserted common law tort and fraudulent transfer causes of action against some of the perpetrators of the scheme. The district court dismissed the receiver's causes of action with prejudice, concluding that the receiver lacked standing, among other things.

In the majority opinion, the Eleventh Circuit "conclude[ed] that the district court erred in dismissing the fraudulent-transfer claims for lack of standing. although the district court correctly concluded that [the receiver] lacked standing to maintain the tort claims, it erred in dismissing those claims with prejudice." The court explained that, under Eleventh Circuit authority, a "receiver has standing to complain about the injuries that the Ponzi entities suffered, not the injuries of the investor victims." Though "[a]t first glance, it may appear counterintuitive that the [Ponzi scheme] entities could complain that they were injured by fraudulent transfers [the entities] engineered," because the receiver's appointment freed the entities from the corporate control of the perpetrators, the receivership restored standing to assert the fraudulent transfer causes of action under Eleventh Circuit authority. Thus, the district court erred in concluding the receiver lacked standing to bring the fraudulent transfer causes of action. But unlike fraudulent transfers, Ponzi torts are not "cleansed through receivership." "[B]ecause the Ponzi torts [are] 'imputed' to the receiver," "Ponzi receivers must meet additional criteria to have standing to maintain tort claims against third parties" under the Eleventh Circuit's decision in Isaiah v. JPMorgan Chase Bank, N.A., 960 F.3d 1296 (11th Cir. 2020). Among other requirements, "the receiver must allege the presence of innocent decision-makers within the corporation to whom fraudulent conduct could [have been reported." Here, the Ponzi entity was not "separate and distinct" from the Ponzi scheme, was not engaged in any legitimate activities, and was "entirely

controlled by fraudsters" (allegations of a few innocent shareholders were insufficient absent further allegations of their ability to control the entity). Thus, the district court had concluded the receiver lacked standing to assert the tort causes of action under *Isaiah*. Though dismissal for lack of standing was appropriate, the district court erred in dismissing with prejudice because dismissal for lack of standing under 12(b)(1) instead requires dismissal without prejudice.

Though the concurring judges agreed that Eleventh Circuit "precedents compel[led] the conclusion that [the receiver] lacked standing to bring his Florida common-law tort claims," Judge Marcus "wr[o]te separately to explain that . . . this use of the term 'standing' is mistaken. The better way to understand the defect in [the receiver's tort claims is that a receiver does not have a cause of action under Florida's common law of tort to sue on behalf of Ponzi corporations." Judge Marcus explained "the term 'standing,' used in its jurisdictional sense, refers to a court's power to hear a case." "Yet, courts over the years have used jurisdictional terms in a loose fashion"—a problem the Supreme Court has cautioned against on multiple occasions, including in Lexmark Int'l, Inc. v Static Control Components, Inc., 572 U.S. 118 (2014), when it explained "the term 'prudential standing' is a 'misnomer' as applied to the question of whether a 'particular class of persons has a right to sue." A plaintiff's right to sue does not affect the court's jurisdiction. Moreover, this mislabeling has dire consequences because (1) courts may raise jurisdictional questions sua sponte and at any time, and (2) dismissal for lack of jurisdiction requires dismissal without prejudice, but the proper dismissal on the merits would typically require dismissal with prejudice. The question before the court in this case, whether the receiver had a right to sue, is an issue that "does not really speak to the court's jurisdiction." A Ponzi corporation is capable of suffering an injury in fact and capable of having standing to assert some claims, and the relevant authorities did not truly answer jurisdictional questions. Instead, they established "that Florida's courts will not recognize that a receiver has a cause of action to sue in common-law tort on behalf of a Ponzi corporation." Though Judge Marcus disagreed with the decisions characterizing the issue as jurisdictional and concluded that "it would be wiser to follow the Supreme Court's instruction to 'bring some discipline' to the use of jurisdictional language," he recognized that the court "remain[s] bound by decisions [it] disagree[s] with." Consequently, he nonetheless concurred in the judgment.

BB. Employment in the Cannabis Industry Does Not Categorically Preclude a Debtor from Receiving Chapter 13 Relief, but Use of Proceeds of Illegal Activity to Fund a Plan Does. Blumsack v. Harrington (In re Blumsack), 657 B.R. 505 (B.A.P. 1st Cir. 2024) (Fagone, J.).

The chapter 13 debtor worked as a "budtender" at a cannabis dispensary—Massachusetts state law permits the retail sale of marijuana—both before and after filing his petition. The income he earned from this job was placed in a checking account that the debtor and his wife held jointly. The debtor's spouse was an engineer, and her income also entered the joint checking account, as did amounts withdrawn from her retirement account. The debtor listed an interest in that joint checking account with a value of \$85 and indicated that although the account had a balance of more than \$70,000 on the petition date, those funds did not belong to him and were attributable to a withdrawal from his spouse's retirement account.

The U.S. Trustee, citing the Controlled Substances Act, asked the bankruptcy court to deny confirmation of the debtor's plan and to dismiss his case. Specifically, the U.S. Trustee argued that by virtue of his employment, the debtor was engaged in criminal activity, and this precluded a determination that his proposed plan could satisfy the good-faith requirements of § 1325(a)(3) and (7). The debtor argued that he should not be ineligible for bankruptcy relief because of the nature of his employment, and that even if his income source was deemed inappropriate for making plan payments, the court should credit his hearing testimony with regard to the use of his spouse's income and retirement funds. The U.S. Trustee noted that the funds were commingled in the joint checking account, that money is fungible, and that the funds are incapable of being segregated within a household.

The bankruptcy court denied confirmation and dismissed the case for cause under § 1307, noting that the debtor violated the Controlled Substances Act; that his plan would be funded from illegal activities, which would require the trustee to knowingly administer wages from an active participant in a criminal enterprise; and that "under an objective standard," the case and plan could not have been filed in good faith. The bankruptcy court also stated that "it would be an abuse of process to permit the Debtor to obtain the protections and benefits of the federal bankruptcy laws while continuing to commit federal crimes," rendering dismissal appropriate under § 105(a), and that it would be inconsistent with the judicial oaths of office taken under 28 U.S.C. § 453 and 5 U.S.C. § 3331 to permit the debtor to obtain the benefits of bankruptcy while engaging in federal crimes.

The B.A.P. disagreed with the bankruptcy court in several respects, holding that the nature of a debtor's employment does not categorically doom a plan and that reliance on § 105 and the judge's oaths of office was error. Under a "totality of the

circumstances" analysis, however, the B.A.P. affirmed the dismissal of the case. The fundamental issue, according to the B.A.P., was that the debtor proposed to fund the plan with the income he derived from his employment at the dispensary; he did not offer his spouse's income or assets unrelated to marijuana activities until after the motion to dismiss was filed. As filed, the plan would have placed the trustee in the untenable position of knowingly administering assets derived from an activity illegal under federal law. These facts showed that the plan did not satisfy § 1325(a)(3). "[P]lans funded with the proceeds of CSA violations are categorically prohibited by § 1325(a)(3)."

CC. The Rooker-Feldman Doctrine Does Not Deprive a Bankruptcy Court of Jurisdiction to Review a State Court's "Incorrect" Interpretation of § 525. Wike v. State Bar of Nev. (In re Wike), 660 B.R. 683 (B.A.P. 9th Cir. 2024) (Lafferty, J.).

The debtor, an attorney in Nevada, was involved in two bar disciplinary proceedings that resulted in the temporary suspension of his license. The state bar also assessed disciplinary costs against the debtor, including the actual costs the bar incurred in relation to his disciplinary proceeding. The debtor then filed for chapter 7 bankruptcy relief and received a discharge.

The debtor was eventually reinstated to the state bar, on the condition that he pay the assessed disciplinary costs. However, the debtor argued that these costs had been discharged in bankruptcy. Moreover, the debtor asserted that the state bar discriminated against him in violation of § 525(a), which prohibits a governmental unit from refusing to renew a license solely because a person filed for bankruptcy relief. The Nevada Supreme Court disagreed, determining that the fees were recoverable by the state bar, "regardless of whether [the disciplinary costs were] discharged in bankruptcy."

The debtor then moved to reopen his bankruptcy case and brought the same arguments to the bankruptcy court. The bankruptcy court determined that it could not review the Nevada Supreme Court's interpretation of § 525(a) under the *Rooker-Feldman* doctrine, which prevents federal review and rejection of state-court decisions.

On appeal, the B.A.P. first concluded that the *Rooker-Feldman* doctrine did not prevent a review of the Nevada Supreme Court's decision. Analogizing to Ninth Circuit cases finding exceptions to the *Rooker-Feldman* doctrine for violations of the automatic stay, determinations of the dischargeability of debts, or the scope of a discharge injunction, the panel determined there were important reasons to permit federal review of the decision. Because § 525(a) acts to bolster the discharge injunction, as well as reduce debtor incentives to reaffirm on a dischargeable debt,

bankruptcy courts are not precluded from reviewing erroneous state court decisions on these core bankruptcy matters.

Next, the panel turned to the merits of the case. After conducting a lengthy review of relevant state and federal law, as well as bar disciplinary rules, the panel concluded that the disciplinary costs were not covered under § 523(a)(7) because they were "not penal" and "meant as compensation for actual pecuniary loss." Accordingly, the disciplinary costs were discharged in bankruptcy. The panel then remanded the case to the bankruptcy court to determine whether § 525(a) had been violated.

DD. Chapter 13 Debtors May Bifurcate and Cram Down a Lien on Their Residence if the Loan Matures During the Term of the Plan. *Mission Hen LLC v. Lee (In re Lee)*, 655 B.R. 340 (B.A.P. 9th Cir. 2023) (Faris, J.).

Debtors Jason Lee and Janice Chen had a home equity line of credit on their residence that was scheduled to mature 59 months after they commenced their chapter 13 case. They proposed a five-year plan that would bifurcate and cram down the junior lien and pay only the secured portion at 5% interest. The creditor objected, but the plan was confirmed over the creditor's objection. The creditor appealed, arguing that the plan violated the anti-modification provision of § 1322(b)(2) by bifurcating its claim into secured and unsecured portions. The debtors argued that § 1322(c)(2) creates an exception to the general rule against modification that applies to claims like the creditor's that mature during the plan term.

Regarding the cramdown and the creditor's anti-modification argument, the B.A.P. stated that, because the HELOC was to mature during the life of the plan, pursuant to § 1322(b)(2) and (c)(2), "the plan may provide for the payment of the claim as modified." The panel rejected the lender's argument that § 1322(c)(2) permits only modification of the payment schedule and not modification of the underlying claim. The B.A.P. noted that its decision was consistent with precedents from the Fourth and Eleventh Circuits, as well as the Sixth Circuit B.A.P.

First, the B.A.P. agreed that the phrase "[n]otwithstanding subsection (b)(2)" explicitly eliminates § 1322(b)(2)'s limitation on loan modification as to soon-to-mature mortgages. Second, application of the "rule of the last antecedent" to the phrase "as modified pursuant to section 1325(a)(5)" refers to the claim, not just payment of the claim. Finally, the B.A.P. agreed that claims that fall within the scope of § 1322(c)(2) are subject to bifurcation, with the unsecured portion subject to cramdown pursuant to § 1325(a)(5).

## EE. Imposition of Sua Sponte Sanctions Requires Higher Standard Akin to Contempt. *In re Frantz*, 655 B.R. 594 (B.A.P. 9th Cir. 2023) (Faris, J.).

After dismissal of their chapter 13 case based on the debtors' uncured default in direct mortgage maintenance payments to creditor, the bankruptcy court issued an order to show cause why the debtors' counsel should not be sanctioned for her statement that the debtors had completed their plan payments when she knew they failed to do so. The bankruptcy court sanctioned counsel sua sponte under Rule 9011, its inherent powers, and a local rule, and later denied a motion for reconsideration.

The BAP began its opinion by stating that it was publishing its opinion to "highlight the standards for and limitations of Rule 9011 sanctions, particularly when the court initiates the sanctions process."

Although the attorney's conduct ranged from "negligent to reckless to seriously misleading" and was "unprofessional and substandard," sua sponte sanctions under Rule 9011 require, at a minimum, conduct that is particularly egregious and similar to conduct that would be sanctionable under the contempt standards. The BAP held that, as a matter of law, there was a reasonable legal basis for her argument that direct payments were not "payments under the plan," so her statement was not frivolous or egregious, and the bankruptcy court erred in sanctioning her.

Concluding its opinion, the BAP articulated, "The standards for imposing monetary sanctions against counsel either under Rule 9011 (particularly when imposed sua sponte by the court) or pursuant to the court's inherent power are unquestionably and necessarily high." The BAP reversed the monetary sanctions, but it also noted that the bankruptcy court had discretion to consider other appropriate actions, including referral to the district court's disciplinary panel.

FF. After Success in Supreme Court, MOAC Wins Only a "Pyrrhic Victory" in the Southern District of New York. MOAC Mall Holdings LLC v. Transform HoldCo LLC (In re Sears Holding Corp.), 661 B.R. 298 (S.D.N.Y. 2024) (McMahon, J.).

As part of the Sears Holdings' chapter 11 bankruptcy case, Transform Holdco purchased the right to designate a lessee to take Sears' rights to a below market, 100-year lease of a three-story building with the Mall of America ("MOAC"). The relevant agreement provided that the lease would pass to Transform's designee "by virtue of the [second] 'sale, transfer, assignment, conveyance and delivery' of the designated lease." MOAC objected to Transform's later attempt to designate the lease to a Transform affiliate. Though the bankruptcy court acknowledged that Transform could never provide adequate assurance that Transform had a similar

financial condition and operation as Sears did in 1991—as the Code section governing assumption and assignment of leases (§ 365(b)(3)) requires of shopping center assignees—the bankruptcy court nonetheless approved the assignment. MOAC appealed and moved for a stay pending appeal. The bankruptcy court denied MOAC's motion for stay pending appeal, in part because Transform assured the court that § 363(m) (which, absent a stay pending appeal, effectively prevents appellate review of a § 363 sale by providing that a sale or lease of property remains valid as to party who purchased in good faith despite reversal or modification on appeal) did not apply and that Transform would not rely on § 363(m) on appeal. Eventually, in MOAC Mall Holdings LLC v. Transform Holdco LLC, 598 U.S. 288 (2023) (Jackson, J.), the Supreme Court determined that § 363(m) was nonjurisdictional and waivable—such that Transform could have waived its ability to rely on § 363(m) by representing in bankruptcy court that § 363(m) did not apply. As a result of that outcome, the bankruptcy court's order approving the assumption and assignment was subsequently vacated—an apparent win for MOAC.

In this appeal, the primary issue before the district court was "whether MOAC's requested remedies [as a result of the vacatur of the assumption and assignment] forfeiture of the Lease to it pursuant to § 365(d)(4), or, alternatively, monetary damages—are permitted by the Code." The court first rejected the "Transform's argument that MOAC is precluded from attacking the Bankruptcy Court's judgment because [MOAC] accepted the benefits of that judgment" by accepting payment from Transform. Transform had forfeited its right to make that argument by failing to raise it during any of the prior litigation. The court next rejected Transform's argument that it should be able to keep the lease under "the ancient common law rule that safeguards title that vests in a good faith purchaser at a judicial sale." That ancient common law rule "applies only to good faith purchasers who were not parties to the proceeding in which the sale order was entered." Because Transform was a party to the judicial proceedings leading up to the sale, the common law rule did not protect it. Thus, the reversal of the assumption and assignment "divested [Transform] of its title." "But that does not get the Lease back to MOAC." Instead, the lease reverted to the estate. The court next explained why the lease rights did not revert to MOAC. Though Sears satisfied the § 365(d)(4) deadline to assume the lease (which the court lacked discretion to extend), the court implied that, under the "clear and unforgiving" terms of § 365(d)(4), its decision vacating that assumption effectively undid that timely assumption. Ordinarily, that conclusion might mean the Code deemed the lease rejected, but "[w]hen the terms of a lease, in economic substance, give all the landlord's rights to the tenant (albeit only for a period of time), the Second Circuit has decreed that § 365(d)(4) will not be applied to work an inequitable forfeiture" of the former tenant's lease. In this case, the court determined the Sears lease was not a "true lease,' in economic terms," for the purposes of § 365(d)(4) because the economic substance of the

parties' agreement (including the long duration, pre-paid low rent, the requirement that Sears pre-pay property expenses including taxes and assessments, and Sears' role in building the store) made Sears' interest more akin to ownership under Second Circuit authority. The court explained the reversion of the lease to the estate, rather than MOAC, was the equitable result because MOAC had already received the benefit of its bargain with Sears and MOAC was never in the dark about Sears' intent to assign the lease. MOAC retained protection under § 365(b)(3), however, against future assignment to an unqualified tenant. The court also determined that neither waiver nor estoppel applied because, among other things, no party could have raised the § 365(d)(4) issue earlier. Thus, the lease "remains with the estate."

Finally, the court determined MOAC lacked a monetary remedy. Neither Transform nor the estate could be liable for damages because (1) the designee's deprivation of the lease is the remedy the Bankruptcy Code imposes when the party designated as assignee of a lease is disqualified; and (2) an exculpation clause in Sears' confirmed plan applied absent "fraud, gross negligence, criminal misconduct or willful misconduct"—none of which had occurred in this case. Calling the vacatur of the assumption and assignment a "Pyrrhic victory for MOAC," the court concluded, "The only thing this ruling does not give MOAC is a way out of its original bargain. But since MOAC freely made that bargain, I am hard pressed to see how MOAC has been damaged in any way that money might compensate . . . nothing was put into the Code to allow landlords to improve their position simply because a tenant declares bankruptcy."

GG. Bankruptcy Court Lacked Discretion to Deny Debtor's Motion to Dismiss Chapter 7 Case Where Unrebutted Presumption of Abuse Arose and Debtor Opposed Conversion. Gallagher v. Cohen, 659 B.R. 57 (D. Md. 2024) (Boardman, J.).

At risk of losing his home in chapter 7, the debtor moved to dismiss his case. The debtor earned more than the median income in his home state, which gave rise to a presumption of abuse under § 707(b). Because he wished to dismiss his case, the debtor reported that he had no special circumstances to rebut that presumption and made no effort to rebut the presumption. The bankruptcy court determined it had discretion to deny the motion to dismiss despite the presumption of abuse. Exercising that discretion, it declined to dismiss the debtor's case, explaining that the debtor "had enjoyed the benefits of the bankruptcy process for over a year, the Trustee had been administering the case, and [the debtor's] creditors would be prejudiced by dismissal." The court concluded "even when the means test gives rise to a presumption of abuse, the bankruptcy court retains the discretion to deny a motion to dismiss based on that presumption."

The district court vacated the bankruptcy court's denial of the debtor's motion to dismiss. Section 707(b)(1) states that the court "may" dismiss a chapter 7 case or convert the case to chapter 11 or 13 "with the debtor's consent" if permitting the debtor to proceed in chapter 7 "would be an abuse" of chapter 7. A presumption of abuse arises if a debtor earned, on average, more than the median income in the debtor's home state during the six months preceding the petition date, but the debtor may rebut that presumption by proving that special circumstances exist. In  $McDow\ v.\ Dudley$ , 662 F.3d 284 (4th Cir. 2011), the Fourth Circuit stated in dicta that when a case is "presumptively abusive" it "must be dismissed unless the debtor can show 'special circumstances," and lower courts in the Fourth Circuit had also concluded dismissal is mandatory. Thus, "the bankruptcy court had a duty to grant the motion to dismiss."

HH. Official Committee Has Standing to Appeal Dismissal of Chapter 11 Bankruptcy Case. Off. Comm. Of Equity Sec. Holders v. Integrated Nano-Techs., Inc., Nos. 23-CV06350-FPG, 23-CV-6351-FPG, 2024 WL 945240 (W.D.N.Y. Mar. 5, 2024) (Geraci, J.).

A chapter 11 equity holders committee opposed dismissal of debtor Integrated Nano-Technologies' bankruptcy. After the bankruptcy court dismissed the case, the court determined that the committee was automatically dissolved and denied its pending fee application. The committee appealed the dismissal and the denial of its fee application to the district court, and the United States Trustee sought to have the appeal dismissed. The UST argued the appeal should be dismissed because the bankruptcy court dissolved the committee, and therefore, the committee lacked standing on appeal.

Judge Frank Geraci, rejecting the majority view, decided the committee retained standing to appeal dismissal. He pointed to § 1103(c)(5) which grants committees broad authority including the power to "perform . . . services as are in the interest of those represented." Although, Judge Geraci emphasized, the Code provides for appointment and termination in other contexts, including trustees and examiners, the Code does not expressly terminate committees when a case is dismissed. Thus, he reasoned, Congress did not intend to create a hardline rule terminating committees upon dismissal. Judge Geraci, however, conceded that a committee's post-dismissal powers are limited by § 1103(c) much like committees have limited powers post-confirmation. As a result, Judge Geraci concluded, the committee does not dissolve at any specific time, but its open-ended authority is inherently limited.

The court determined that the committee had standing and was acting within its authority in appealing the dismissal order because it was acting in the interest of those represented and because the committee was directly harmed by the dismissal of the case.

II. Lockup Agreement Impermissible Under § 1125(b). In re Gol Linhas Aéreas Inteligentes, S.A., 659 B.R. 641 (Bankr. S.D.N.Y. 2024) (Glenn, J.).

Early in their cases, chapter 11 debtors entered into so-called "lockup" agreements with lessors of aircraft and engines that the debtors used to operate their airline business. The agreements (1) "resolv[ed] certain disputes relating to, among other things, unpaid basic and deferred rent, maintenance reserves, cash collateral, the retention and application of security deposits, and the amendment and assumption of various aircraft and engine leases"; (2) required the lessors to vote in favor of any plan that was consistent with the "economic substance" of the agreements, subject to certain financial conditions and approval of the disclosure statement; and (3) provided that the court could strike the lockup component and still approve the economic substance of the deal. The United States trustee and unsecured creditors' committee objected to the debtor's motion to approve the lockup agreements.

The court sustained the United States' trustee and committee's objections but approved the economic substance of the agreements. Under Rule 9019, the court could only approve the lockup agreements if it determined they were "fair and equitable and in the best interests of the estate" in light of several common law factors. And though the court should defer to the debtor's business judgment, "settlements cannot be allowed to trample on the rights and protections expressly created by section 1125 of the Bankruptcy Code," which prohibits plan solicitation before the voting creditor receives a summary of the plan and the court approves a disclosure statement containing adequate information. Though the Code and case law encourage debtors and creditors to negotiate plan terms and enter into restructuring support agreements, the lockups here were missing critical features of such negotiations and agreements, including (1) "adequate (or any) information about the plan terms" and (2) "a meaningful choice" for creditors to rescind based on new information. Here, the debtors were "months away from filing a disclosure statement," the agreements required the creditors to vote "for any plan the Debtors may later propose," and the creditors had "no meaningful 'outs' . . . to void the blank check they [were] writing." The creditors' sophistication and the debtors' interests in the certainty of the deal did not permit the debtors to circumvent § 1125(b), which served in this instance to protect other, smaller creditors and prohibited the lockup agreements.

JJ. A Subchapter V Trustee Does Not Have Standing to Commence an Adversary Proceeding on Behalf of the Bankruptcy Estate. Singh v. Price (In re Turkey Leg Hut & Co. LLC), 659 B.R. 539 (Bankr. S.D. Tex. 2024) (Rodriguez, J.).

Debtor Turkey Leg Hut & Company commenced a chapter 11 bankruptcy proceeding, electing to proceed under subchapter V. The trustee initiated an adversary proceeding against the husband of the debtor's representative, requesting

the bankruptcy court to enjoin him from interfering with the debtor, including entering any of the debtor's properties or removing its property.

Although the issue was not raised by the parties, the bankruptcy court determined that it had to determine whether the trustee had standing to file an adversary complaint on behalf of a debtor in possession. Section 1184 gives a debtor in possession the power to litigate causes of action. Under § 1183, the trustee has various duties and powers. For instance, the trustee must appear and be heard at various hearings in a case, work with the parties to facilitate a consensual plan of reorganization and ensure that plan payments are commenced in a timely fashion after confirmation. But nowhere is the trustee given the authority to pursue litigation on behalf of the bankruptcy estate.

Accordingly, the bankruptcy court determined that the trustee lacked standing and denied the trustee's request for injunctive relief.

## KK. A Chapter 13 Debtor May Pay Off a Plan Early with the Proceeds of a Refinancing Loan. *In re Montenegro*, 655 B.R. 607 (Bankr. S.D. Fla. 2023) (Mark, J.).

Debtor Raquel Montenegro sought to refinance the debt on certain non-exempt real property for "significantly more" than the secured debt amount determined by a valuation order entered earlier in the case. The question presented was whether the debtor could use the new loan proceeds to pay her secured and unsecured chapter 13 plan obligations early and keep any remaining proceeds, or whether the proceeds in excess of the stripped-down secured debt had to be used to increase the distribution to unsecured creditors.

In connection with the proposed refinancing, the debtor filed a motion to modify her plan, proposing to make a lump-sum payment to fully pay the remaining amounts due under the confirmed plan to tax creditors, the secured portion of the stripped-down debt, and unsecured creditors. The trustee opposed the motion, citing to § 1329(b), which states that § 1325(a) applies to modified plans. Section 1325(a)(4) requires a debtor to provide value to the unsecured creditors as of the "effective date" of the plan that is not less than the amount the unsecured creditors would receive in a chapter 7 liquidation on that date. The trustee argued that the "effective date" for purposes of § 1325(a)(4) is the effective date of the modified plan, so that the value that unsecured creditors would receive on the effective date must be based on the appreciated value of the real property.

In response, the debtor withdrew the motion to modify the plan, arguing that she didn't need to modify her plan to pay it off early. The trustee replied that a debtor cannot complete an early payoff without a modification because § 1329(a)(2) says

that a modified plan is required to extend or reduce the time for payments under the confirmed plan.

The bankruptcy court agreed with the trustee that the plan must be modified to permit an early payoff, and that the effective date for the best-interests test is the modification date. However, the court held that the debtor's modified plan still met the test because (1) a chapter 13 debtor is entitled to the appreciated value of property upon conversion, and (2) even if a chapter 7 trustee could sell the real property in question, all the proceeds would be paid to the secured creditor because the stripped-down valuation would no longer apply under § 348(f)(1)(B) and (C).

In so holding, the court identified a split in opinions in the Eleventh Circuit, and even more specifically within the Southern District of Florida, regarding early payoffs. But the court agreed with "well-reasoned statutory analysis" concluding that plans modified under § 1329(b) are not subject to the applicable-commitment-period requirements in § 1325(b)(4).

LL. Debtors Cannot Recover Emotional-Distress Damages for Violations of the Discharge Injunction. Vadellon v. Wells Fargo Bank. N.A. (In re Valdellon), 659 B.R. 377 (Bankr. E.D. Cal. 2024) (Jaime, J).

The debtors brought an adversary proceeding against their mortgagee under § 524(a)(2) and (i), alleging that the mortgagee willfully failed to credit payments it received under their chapter 13 plan. Importantly, the debtors sought damages for emotional distress. The mortgagee filed a motion to dismiss the complaint.

The key issue before the bankruptcy court was whether the debtors could recover emotional-distress damages for the mortgagee's violation of the discharge injunction. Other courts have often addressed this issue by analogizing to violations of the automatic stay. Because emotional-distress damages are typically available for violations of the stay, these courts conclude they should also be available for violations of the discharge injunction.

However, the bankruptcy court noted that these cases predate the Supreme Court's decision in *Taggart v. Lorenzen*, 587 U.S. 554 (2019). According to the bankruptcy court, *Taggart* makes clear that the discharge injunction should be analyzed based on "traditional principles' of civil contempt and not § 362 by analogy." Applying this lens, the bankruptcy court noted that the historical remedy for civil contempt was compensatory damages. Relying on early American common law and decisions from other circuits, the bankruptcy court concluded that emotional-distress damages have long been categorized as non-pecuniary and non-compensatory.

Therefore, the court concluded, emotional-distress damages are not recoverable for violations of the discharge injunction. A plaintiff may recover only for pecuniary loss.

MM. A Class of Creditors Does Not Accept a Subchapter V Plan if No Creditors in the Class Submit Ballots. *In re M.V.J. Auto World, Inc.*, 661 B.R. 186 (Bankr. S.D. Fla. 2024) (Isicoff, J.); *In re Florist Atlanta, Inc.*, No. 24-51980-pwb, 2024 WL 3714512 (Bankr. N.D. Ga. Aug. 7, 2024) (Bonapfel, J.).

Debtor M.V.J. Auto World, Inc., sought a consensual confirmation of its subchapter V plan under § 1191(a), but not all impaired classes voted to accept the plan. The bankruptcy court held that when an impaired class of creditors fails to accept a subchapter V plan, that plan cannot be consensually confirmed under § 1191(a).

The debtor's plan contained two impaired classes. Although one class voted to accept the plan, no creditors in the other class submitted ballots. At the confirmation hearing, the United States trustee, the subchapter V trustee, and the impaired creditor who voted to approve the plan all argued that the plan could not be confirmed under § 1191(a) because less than all impaired classes affirmatively accepted the plan.

Section 1191(a) provides that the court shall confirm a plan under that provision "only if all of the requirements of section 1129(a), other than paragraph (15) of that section," are met. Section 1191(b), however, permits confirmation even where paragraphs (8), (10), and (15) of § 1129(a) are not satisfied, so long as the plan does not discriminate unfairly and is fair and equitable. Section 1129(a)(8), meanwhile, requires that "[w]ith respect to each class of claims or interests—(A) such class has accepted the plan; or (B) such class is not impaired under the plan." Because one class of impaired claims in this case did not accept the Debtor's plan, § 1129(a)(8) was not satisfied.

Though the Debtor, citing two cases from the Southern District of Texas, argued that when an impaired class of creditors does not vote, that class should not be counted at all for purposes of § 1129(a)(8), the court did not agree. A plain reading of the relevant statutes indicates that § 1129(a)(8) must be satisfied, and because it was not, the plan could be confirmed under § 1191(a).

Similarly, Judge Bonapfel in *In re Florist Atlanta* confronted similar facts. Out of three impaired classes, only one voted in favor of the plan. No other creditors voted or objected to plan confirmation. Judge Bonapfel discussed the split in authority and sided with the majority view that "acceptance for purposes of § 1129(a)(8) requires affirmative acceptance by the class."

NN. Class with No Votes is Not Considered in Confirming a Subchapter V Plan. *In re Franco's Paving LLC*, 654 B.R. 107 (Bankr. S.D. Tex. 2023) (Jones, J.); *In re Hot'z Power Wash, Inc.*, 655 B.R. 107 (Bankr. S.D. Tex. 2023) (Rodriguez, J.).

Two Southern District of Texas bankruptcy judges both concluded that in Subchapter V, a class that does not vote is not considered when counting votes for confirmation. In *Franco*, three classes voted in favor of the plan while three did not vote. The United States Trustee objected to confirmation, arguing that the plan did not comply with § 1191(a) because not all classes voted in favor of the plan as required under § 1129(a)(8). In *Hot'z*, one class did not vote while the other two voted in favor of the plan. Additionally, the debtor included a notice provision in the plan which provided that any non-voting class is deemed to accept the plan.

Both Judge Rodriguez and former Judge Jones analyzed § 1126(c) and determined that Congress could not have intended to include classes that did not vote when calculating class acceptance because under § 1126(c), the denominator only includes votes actually cast. Therefore, in a non-voting class, the denominator would be zero and lead to a mathematical conundrum. Both judges also rejected contrary authority holding that non-voting is implicit acceptance or implicit rejection. Thus, the only option was to ignore the non-voting class altogether. Judge Rodriguez noted that this result is favorable because it prevents the debtor from having to shoulder the additional burdens of cramdown when a class simply does not vote.

Note: for background information and suggested statutory fixes, see Stephen W. Sather & Barbara M. Barron, *Voting and the Apathetic Creditor*, XXXIX ABI Journal, December 2020, at 12, 53–54.

OO. Principal's New Value Contribution Did Not Save Plan from Absolute Priority Rule Violation. In re Cleary Packaging, LLC, 657 B.R. 780 (Bankr. D. Md. 2023) (Harner, J.).

This case is noteworthy for its explanation of the absolute priority rule. The relevant facts are as follows: the chapter 11 debtor proposed a 60-month plan that would have permitted its principal to retain his 100% ownership interest without paying 100% of the claims of general unsecured creditors who opposed confirmation—in violation of the absolute priority rule. The debtor sought to satisfy the new value exception to the absolute priority rule by requiring the principal to contribute new value in the form of: "(i) his sweat equity; (ii) the payment on his prepetition claim against the Debtor (arguably approximately \$2,000 in wages and \$47,000 in commissions); (iii) his \$35,000 post-petition (and preconfirmation) loan to the Debtor; and (iv) \$25,000 (presumably in cash) from his retirement account."

"[T]he absolute priority rule requires that each class of impaired and unaccepting creditors be paid in full prior to any junior class of claims or interests receiving any distributions under the plan." Pre-petition equity owners may not retain their ownership interests without satisfying the absolute priority rule. But "courts have developed the new value exception to the absolute priority rule, which allows prepetition equity to purchase (and thereby retain) their ownership if certain conditions are met." Specifically, owners may not "purchase" their post-bankruptcy ownership if the opportunity to purchase is offered exclusively to the existing owners (i.e. the offer is not tested in the market) and "without consideration of alternatives." "A market test may be necessary in certain cases if a debtor is not able to demonstrate new, substantial, and equivalent value through other admissible evidence." The new value offered must be "(i) new, (ii) substantial, (iii) in money or money's worth, (iv) necessary for a successful reorganization, and (v) reasonably equivalent to the value of the stock being retained or received." In determining whether new value is substantial, the court compares the new value to "(1) the total unsecured claims against the debtor, (2) the claims being discharged, or (3) the dividend being paid on unsecured claims by virtue of the contribution."

In this case, the debtor's proposed new value was insufficient. The debtor's sweat equity, debt forgiveness, and proposal to make a new loan were neither new nor for money or money's worth. As the court explained, "the concept of new value is intended essentially to measure the amount of new capital being infused into the debtor; it is not intended to capture lending or financing arrangements." The sweat equity, debt forgiveness, and \$25,000 contribution were not substantial in comparison to the total unsecured claims, claims being discharged, and dividend being paid by virtue of the contribution. The court denied confirmation of the debtor's proposed plan.

PP. Debtor's Bankruptcy Filing Was Not in Bad Faith Even Though the Debtor Was Not Experiencing Financial Distress. *In re Aldrich Pump LLC*, No. 20-30608, 2023 WL 9016506 (Bankr. W.D.N.C. Dec. 28, 2023) (Whitley, J.); *In re Bestwall LLC*, 658 B.R. 348 (Bankr. W.D.N.C. 2024) (Beyer, J.).

Trane Technology, facing over 90,000 asbestos lawsuits, engaged in the "Texas Two-Step," creating multiple entities, and shifting most of the debt of the conglomerate to the debtors. The debtors had no employees, very little business, and very few assets. The debtors' assets would certainly be insufficient to cover the asbestos liability, but the debtors had funding agreements with non-debtor affiliates that provided that, if the debtors confirmed a § 524(g) plan shielding the entities possessing the conglomerate's assets, an asbestos trust would pay 100% of the allowed asbestos claims. More than three years into the cases, various parties filed

challenges to the debtors' cases alleging several things, including that the cases were filed in bad faith because the debtors were not financially distressed.

The court agreed that the debtors were not in financial distress, but rejected the argument that the court did not have jurisdiction and that the filings were in bad faith. The court determined that eligibility generally and financial distress specifically was not a prerequisite to bankruptcy court jurisdiction under the Code or the Constitution. Further, the court concluded that this was not a bad faith filing in the Fourth Circuit where in order to determine that a case was filed in bad faith, the court must find that the case is objectively futile and that the debtor possessed subjective bad faith.

In *In re Bestwall LLC*, Case No. 17-31795, 2024 WL 721596 (Bankr. W.D.N.C. Feb. 21, 2024), a similar case also out of the Western District of North Carolina, creditors raised the same issue of whether financial distress is a prerequisite to bankruptcy court subject matter jurisdiction. In that case, Judge Beyer discussed the history of bankruptcy law in the United States and, like Judge Whitley, found no basis for the argument that financial distress was a prerequisite to jurisdiction. Judge Beyer further reasoned that if Congress had intended to add such a specific jurisdictional limitation, it would have done so in § 109.

QQ. Chapter 13 Debtor Who Was Not Personally Liable on a Mortgage Could Cure Mortgage Default in Chapter 13 Plan. *In re Stevenson*, Case No. 23-32811-KRH, 2023 WL 7401456 (Bankr. E.D. Va. Nov. 8, 2023) (Huennekens, J.).

The chapter 13 debtor in this case had inherited investment property pre-petition. On the petition date, the property was encumbered by a mortgage debt that included significant arrears. The debtor had no personal liability on the mortgage and was not in privity of contract with the mortgage lender. In the chapter 13 plan, the debtor proposed to pay ongoing mortgage payments directly and cure the prepetition arrearage over 34 months. To cure the arrearage over time, the debtor relied on the § 1322(b)(2), which permits debtors to "modify the rights of the holders of secured claims." The lender objected, arguing the debtor could not cure the prepetition arrearage because the mortgage was not a "claim" against the debtor within the meaning of § 1322(b)(2).

Noting a split in authority, the United States Bankruptcy Court for the Eastern District of Virgina sided with the "majority of courts" and concluded the mortgage was a "claim" that the debtor could modify despite the lack of *in personam* liability. The court relied on *Johnson v. Home State Bank*, 501 U.S. 78 (1991), in which the Supreme Court determined that a creditor has a "claim" under § 101(5) if it has a right to payment that is enforceable against either the debtor or the debtor's

property. Finding no reason to distinguish the circumstances before it from *Johnson*, the court determined the mortgage was a claim and § 1322(b)(2) permitted modification. Accordingly, the court overruled the lender's objection to confirmation.

RR. Chapter 13 Debtor Who Lacked Legal Title in Underlying Property Could Not Cure Deceased Parents' Mortgage Default Under § 1322(b)(5). *In re Higgins*, No. 23-22024-rmb, 2023 WL 8823920 (Bankr. E.D. Wis. Dec. 20, 2023) (Blise, J.).

Pre-petition, the chapter 13 debtor's parents died intestate. The lender holding a mortgage on the parents' home subsequently commenced foreclosure proceedings and received a foreclosure judgment, but no probate proceedings had commenced as of the date the debtor commenced his chapter 13 case. Thus, the debtor lacked legal title to the property on the petition date. In his chapter 13 plan, the debtor proposed to maintain the monthly payment on his parents' home mortgage and cure his parents' significant prepetition mortgage arrearage throughout the life of the 60-month-plan. The debtor had no personal liability on the mortgage and was not in privity of contract with the mortgage lender. The mortgage creditor opposed confirmation and sought stay relief.

As the bankruptcy court explained, "[t]he ultimate issue raised by the lender's objection to confirmation and motion for relief from stay is whether the debtor can 'cure and maintain' his parents' mortgage through his chapter 13 plan. The answer to that question depends on whether [the lender] has a claim against the debtor's interest in the Property such that it has a claim under 11 U.S.C. §§ 101(5) and 102(2)." The court had already determined that "a chapter 13 plan may provide for the cure of default and maintenance of payments under § 1322(b)(5) even where the debtor is not personally liable on the debt and is not in contractual privity with the creditor so long as the creditor has an interest in property owned by the debtor." But, under the facts of this case, the creditor did not have an interest in property owned by the debtor. The debtor had no right to take action with respect to the home itself under Wisconsin probate law, but instead had only a possessory interest and a potential equitable interest in the probate estate. Those interests were insufficient to make the home "property of the debtor" within the meaning of § 101(2). Because the lender did not have a "claim against property of the debtor," there was nothing for the debtor to cure and maintain through the plan. The court sustained the lender's objection to confirmation and granted the motion for relief from stay.

SS. The Issue of Whether an Injury is Willful and Malicious for the Purposes of Determining Dischargeability is Subject to Collateral Estoppel. *Heslin v. Jones (In re Jones)*, 655 B.R. 868 (Bankr. S.D. Tex. 2023) (Lopez, J.).

Alex Jones and his business were sued in state court by the families and victims of the Sandy Hook Elementary School Shooting after Jones made false and damaging statements about the shooting on his show. Alex Jones defaulted in state court as a result of consistent misconduct during the discovery phase. As such, the allegations were deemed admitted. After a massive judgment was rendered against Alex Jones and his business, he filed bankruptcy under chapter 11. The families and victims, now creditors, sought a determination that the debt was nondischargeable as a willful and malicious injury under § 523(a)(6) and moved for summary judgment. They argued that the issue of willfulness and maliciousness was already decided by the state court and that collateral estoppel applied. Alex Jones argued that the issue was not actually litigated and even if it was, summary judgment against him would violate public policy and would be unconstitutional.

The court applied state law to determine whether collateral estoppel applied. Under Connecticut law, an issue cannot be relitigated when the issue was fairly litigated and necessarily determined in a prior action between the same parties on a different claim. The court looked to the extensive record from the state court and determined that the state court had sufficient findings establishing willfulness and maliciousness because the debtor was deemed to admit to allegations establishing that he intended to cause harm, knew that other individuals were harassing the plaintiffs, and had a malicious obsession with his own conspiracy theory regarding the events at Sandy Hook. The court also quickly rejected the debtor's ancillary arguments on fairness and constitutionality.

TT. Bankruptcy Court Retains Jurisdiction of Malpractice Claim Involving the Interpretation of Chapter 11 Plan Exculpation Provisions. Murray v. Wilkie Farr & Gallagher LLP (In re Murray Energy Holdings Co.), 654 B.R. 469 (Bankr. S.D. Ohio 2023) (Hoffman, J.).

The chapter 11 debtor's plan provided that the debtor must withdraw from a union pension plan which resulted in \$6.5 billion in liability. Although the debtor's plan provided for the discharge of this liability with respect to the debtor, the debtor's owner was still liable. The pension plan quickly sued the owner. After the owner died, his representatives sued the law firm that represented the owner during the bankruptcy. The representatives alleged that the law firm failed to inform the owner that the debt was not being released and failed to negotiate a plan including a third-party release. The plan, however, included exculpation provisions that may

protect the law firm from the malpractice claims. The law firm contended that the plan exculpated them. In response, the owner's attorneys argued that the bankruptcy court lacked jurisdiction. Both parties sought enforcement of the arbitration agreement included in the engagement letter between the owner and the law firm (though the law firm only sought arbitration if the adversary proceeding was not dismissed for failure to state a claim).

The court first analyzed whether it had jurisdiction. The court conducted a lengthy discussion of the three forms of bankruptcy court jurisdiction: (1) "arising under;" (2) "arising-in;" and (3) "related-to." The court determined that "arising in" jurisdiction applied because the claim met the Sixth Circuit's "but for" test. The court reasoned that because the case turns on interpretation of the chapter 11 plan and because the malpractice claim relates to the law firm's conduct during the bankruptcy, the claim would not exist but for the bankruptcy. And because the case "stemmed from the bankruptcy itself," the court had constitutional jurisdiction as well, making this a core proceeding. The court next considered whether enforcing the arbitration agreement would create an inherent conflict with the Bankruptcy Code. The court concluded that allowing arbitration to proceed would unduly interfere with the "undisputed power of a bankruptcy court to enforce its own orders" because the chapter 11 plan which included the exculpation clauses at issue. is an order of the court. The court also declined to abstain because the mandatory abstention provisions of § 1334(c)(2) do not apply to core proceedings, and permissive abstention is not appropriate because of the relatedness of this cause of action to the bankruptcy. Thus, the court reached the merits and dismissed the malpractice claim under 12(b)(6) as barred by the exculpation provisions.

### UU. Lender's Alleged Manufacture of Venue Did Not Justify Transfer. In re AmeriFirst Fin., Inc., Case No. 23-11240-TMH, 2023 WL 7029873 (Bankr. D. Del. Oct. 25, 2023) (Horan, J.).

The debtor was an Arizona mortgage company that could not have independently filed a bankruptcy case in Delaware. Pre-petition, a New York based lender created a Delaware holding company and transferred all of the debtor's common stock to that holding company. On the same day, the holding company removed the debtor's directors and executives, installed replacements, then filed its own bankruptcy case in Delaware. Soon after, the debtor—now controlled by the executives and directors the lender installed—filed a chapter 11 case in Delaware, a venue that would have been unavailable for the debtor if the affiliated holding company had not already filed its Delaware case. The United States Trustee and others asked the court to transfer venue to Arizona in the interests of justice.

The bankruptcy court denied the motion to transfer venue. "Under 28 U.S.C. § 1408(2), any affiliate of a debtor may file a bankruptcy petition in the same

district as" another debtor with a case pending in that district. Thus, the debtor in this case could obtain venue in Delaware by virtue of the holding company's properly venued case. Section 1412, however, permits transfer to another venue "in the interest of justice or for the convenience of the parties." Courts typically "afford great weight to debtor's selection of venue." But in this case, the movants argued the court should not give deference to the debtor's venue selection because the lender "manufactured venue" in Delaware. The court disagreed. Despite the circumstances surrounding the affiliate's creation and bankruptcy filing, the debtor did not act in a brazen manipulation of venue, the debtor's chief restructuring officer's testimony supported the conclusion that the debtor's venue selection was appropriate, and the debtor's board independently determined the debtor's venue selection was appropriate. Cases arriving at opposite conclusions were distinguishable. The factors courts consider when determining whether the interests of justice favor transfer were otherwise neutral or only slightly favored transfer or retention. Consequently, the movants did not satisfy their burden of establishing by a preponderance of the evidence that the court should transfer venue.

VV. Court Sanctions Creditor Approximately \$826,000 for Filing Baseless Proof of Claim. *In re Highland Cap. Mgmt., L.P.*, No. 19-34054-sgj-11, 2024 WL 959335 (Bankr. N.D. Tex. Mar. 5, 2024) (Jernigan, J.).

The debtor and creditor in this case co-owned an entity pre-petition. As amended, the creditor's proof of claim sought an unliquidated amount of damages based on allegations that "organizational documents relating to [the co-owned entity] improperly allocated the ownership percentages of the equity members, due to mutual mistake, lack of consideration, and/or failure of consideration." The debtor objected to the claim. On the eve of scheduled depositions of the creditor's principals, after having deposed the debtor's principals, soon before trial on the merits of the claim objection, and "after almost three years of protracted litigation" the creditor moved to withdraw the claim without prejudice to its future efforts to litigate the issues central to the claim objection. "Painfully, after all this," the court nonetheless held a trial on the proof of claim and sustained the debtor's objection. At trial, a witness for the creditor all but admitted that the creditor filed its proof of claim because it "was frustrated with the consequences of [the debtor's principal's decision in 2019 to seek bankruptcy protection for [the debtor]." The debtor subsequently sought sanctions against the creditor "for its filing, prosecution, and then abrupt attempt to withdraw a meritless proof of claim."

After taking additional evidence, the bankruptcy court sanctioned the creditor \$825,940.55 to reimburse the debtor for the fees and costs it incurred litigating the

creditor's proof of claim. Under § 105(a) and its civil contempt power, "[a] bankruptcy court may sanction a litigant for bad faith filing or litigation if the court makes specific findings, based on clear and convincing evidence, of bad faith or willful abuse of the judicial process." Here, the court found clear and convincing evidence of bad faith from evidence that the creditor and its principal completed and filed the proof of claim (which contained only one paragraph setting forth its basis) without conducting due diligence or investigating the proof of claim's truth or accuracy, from the creditor's vexatious litigation tactics, and from evidence establishing the creditor lacked factual and legal basis for its claim. The creditor's principal's "I'm-a-very-busy-person/too-busy-to-be-bothered-to-investigate' excuse [was] not a defense, as a matter of law, to his bad faith and willful abuse of the judicial process in connection with the filing of the Proof of Claim," and his allegation that he relied on systems and processes within the creditor entity was not supported by evidence. Rejecting the creditors' arguments concerning the amount of compensatory damages the debtor requested, the bankruptcy court ordered the creditor to pay the debtor \$825,940.55—the amount required to reimburse the debtor for the attorneys' fees and costs it incurred due to the creditor's sanctionable conduct.

### WW. Court Sanctions Debt Relief Agency \$10,000. In re White, 659 B.R. 68 (Bankr. D.S.C. 2024) (Burris, J.).

In January 2023, the debtor contacted a debt relief agency seeking to save her home from foreclosure. The debtor paid the debt relief agency approximately \$1,800 in February 2023 and took her credit counseling course in March 2023. Despite the pending foreclosure and despite the debt relief agency's prior promises (in stipulations resolving similar allegations of misconduct in other bankruptcy cases) that it would not collect fees from a debtor who had not received advice from an attorney admitted to practice in that debtor's home district, the uncontradicted evidence before the court established that the debt relief agency did not put the debtor in contact with an attorney who was licensed to practice in the debtor's home district until approximately June 2023 and did not file the debtor's bankruptcy petition until July 2023. The debtor's home was sold pre-petition, in early June 2023.

The bankruptcy court sanctioned the debt relief agency \$10,000. Section 329 of the Bankruptcy Code and Rule 2017 of the Federal Rules of Bankruptcy Procedure authorize courts to order the refund of excessive compensation. Section 526, the Code section that imposes restrictions on debt relief agencies and provides remedies for noncompliance, further authorizes courts to impose civil penalties and injunctions. Here, the debt relief agency violated § 526 by failing to have an attorney who was licensed in the home district engage in required pre-petition

duties and by making misrepresentations on its website and in filings before the court. The debt relief agency "show[ed] a disregard for the truth and blame[d] others—including the injured party—for its own shortcomings." The debt relief agency's "disregard of its duties" "robbed [the debtor] of the chance to [succeed in chapter 13]" and amounted to "an irreversible, avoidable mistake that has set the Debtor's life down an unnecessary path." The court cancelled the debt relief agency's retainer agreement with the debtor under § 329 and imposed a \$10,000 civil penalty under § 526—though the debt relief agency could satisfy this amount in part by refunding the debtor the retainer amount.

XX. Under Fourth Circuit Authority, Best Interests of Creditors' Test Calculated as of Modification Required Payment of Sale Proceeds Attributable to Post-Petition Appreciation, but Not to Debtor's Post-Petition Payments. *In re Adams*, 654 B.R. 703 (Bankr. M.D.N.C. 2023) (Kahn, J.).

After converting from chapter 7 to chapter 13 and confirming a plan, the debtor sold his residence. The debtor's confirmed plan required him to pay approximately \$80,000 nonexempt equity—\$60,000 of which was attributable to the debtor's nonexempt equity in his residence valued as of the petition date. But because the debtor's home appreciated post-petition, the post-petition sale of the debtor's residence realized more than \$95,000 net proceeds (after payment of his exemption). The trustee moved to modify the confirmed plan to increase the distribution to unsecured creditors by the approximately \$30,000 additional nonexempt net sale proceeds. The debtor opposed the motion, arguing confirmed plan was res judicata and the plan could not be modified under § 1329.

The court permitted the trustee's modification. Res judicata prevents modification absent a substantial and unanticipated change in the debtor's ability to pay. Here, the sale resulted in a substantial and unanticipated change in the debtor's ability to pay by creating a significant amount of readily available cash under circumstances the trustee could not have reasonably anticipated as of the date of confirmation. As to the debtor's arguments under § 1329, the modification was permissible as an "increase . . . [to] the amount of payments on claims of a particular class" under § 1329(a)(1) and a "reduc[tion in] the time for such payments" under § 1329(a)(2). The trustee's proposed modification also complied with the relevant provisions of the Bankruptcy Code under § 1325(a)(1). The modified plan was proposed in good faith under § 1325(a)(3) because it was necessary to prevent the debtor from receiving a windfall.

As to the requirement that the proposed modification satisfy the "best interest of creditors" test under § 1325(a)(4) (and, therefore, pay general unsecured creditors at least as much as they would have received in a chapter 7 case), the bankruptcy

court explained that the test applies "as of the effective date of the plan," and determined that the "effective date of the plan" refers to the date of modification in the Fourth Circuit (unlike in the Eighth Circuit, where "[t]he effective date is not altered by modification of the plan, for the modified plan remains, ever constant, the plan." Forbes v. Forbes (In re Forbes), 215 B.R. 183, 189 (B.A.P. 8th Cir. 1997)). That "conclusion, however, [did] not necessarily determine which property interests are considered for purposes of determining the liquidation value." Critically, "the property interests to be included in the valuation as of the effective date of the modified plan include only those interests under § 541," that existed as of the petition date "and excludes those interests that have come into the estate postpetition under § 1306" that became property of the estate during the plan. court explained, "[t]he distinction is in the property interests at issue. Appreciation is attributable to the property interest Debtor held on the petition date, while paydown of equity is attributable to Debtor's interest in his post-petition income that would not have been property of the estate in a hypothetical chapter 7." Consequently, in this case, the liquidation analysis required payment of the net sale proceeds, less any principal reduction resulting from the debtor's post-petition mortgage payments. The court granted the trustee's motion to modify and gave additional time to permit the parties to stipulate to the "appropriate amounts of remaining unpaid liquidation value."

## YY. Non-Filing Spouse's Social Security Income Excluded from § 707(b) Calculation. *In re Hamilton*, 655 B.R. 911 (Bankr. S.D. Ohio 2024) (Buchanan, J.).

This case required the court to determine, among other issues, whether the debtor could exclude her non-filing spouse's social security income from § 707(b)'s disposable income analysis. As the court explained, § 707(b)(3) authorizes dismissal of a chapter 7 petition "if a debtor files a petition in 'bad faith' or when 'the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." The United States Trustee argued this "totality of the circumstances" inquiry permits inquiry into the financial benefits a debtor receives through social security benefits—even though relevant social security law states that those benefits are not "subject to . . . the operation of any bankruptcy or insolvency law," language that "impose[s] a broad bar against the use of any legal process to reach all social security benefits."

Noting a split in authority about the treatment of social security income in bankruptcy, the court concluded that "excluding social security income as a factor in determining financial need for bankruptcy relief should not mandate a finding of abuse under § 707(b)(3)(B)." The court first explained that "in one form or another, circuit courts of appeal have upheld the protection of social security income within

the confines of the Bankruptcy Code." See, e.g., Carpenter v. Ries (In re Carpenter), 614 F.3d 930 (8th Cir. 2010) (concluding that 42 U.S.C. § 407 excludes all social security benefits from the bankruptcy estate). Thus, circuit court authority demonstrated "a deep rooted understanding that social security income is afforded special protection under § 407 of the Social Security Act, even within confines of the Bankruptcy Code." Lower courts, however, disagree about the scope of the Social Security Act's safeguard against bankruptcy process with "well reasoned opinions on both sides." Some conclude that the inquiry under § 707(b) does not implicate the Social Security Act's safeguard against bankruptcy. Others conclude that the Social Security Act's specific exclusion of social security income from the operation of bankruptcy law prevents bankruptcy courts from considering that income. Ultimately, the court concluded "the implication that courts should deny chapter 7 relief to debtors unwilling to commit social security income towards the repayment of their creditors using an expansive reading of § 707(b)(3)(B) is inconsistent with the protections afforded social security income under the Social Security Act." Consequently, the debtor's exclusion of her non-filing spouse's social security income did not "result in an abuse of the chapter 7 process." After also determining the debtor's voluntary 401(k) contributions were permitted as a reasonable deduction from the debtor's disposable income under § 707(b), the court denied the United States Trustee's motion to dismiss.

ZZ. Bankruptcy Court Has Authority to Extend Deadline to File Subchapter V Plan for Circumstances Beyond the Debtor's Control. *In re Trinity Legacy Consortium*, *LLC*, 656 B.R. 429 (Bankr. D.N.M. 2023) (Jacobvitz, J).

The debtor sought additional time to file a subchapter V plan. The debtor had already requested and received four extensions so that that debtor could engage in negotiations with its creditors. At the time of the request at issue in this case, the debtor was actively engaged in mediation. Two creditors who were not parties to the mediation objected to a fifth extension, arguing that subchapter V requires speedy resolution of cases, and that mediation was not out of the control of the debtor.

The court discussed three approaches in determining whether the need to extend the time to file a plan is "attributable to circumstances for which the debtor should not justly be held accountable" under § 1189(b). The first test asks whether the circumstances are beyond the debtor's control. This test disregards equitable considerations such as whether creditors would be prejudiced and the debtor's good faith. The second test considers the following four factors: "(1) whether the circumstances raised by debtor were within his control, (2) whether debtor has made progress in drafting a plan, (3) whether the deficiencies preventing that draft from being filed are reasonably related to the identified circumstances, and (4)

whether any party-in-interest has moved to dismiss or covert debtor's case or otherwise objected to the deadline extension in any way." Ultimately, the court embraces a third approach in which the court conducts a comprehensive analysis considering all relevant equitable factors. The court relied on the representations from debtor's counsel claiming that they were close to a deal with two of its major creditors and approved a one-month extension.

AAA. When Determining Subchapter V Eligibility, the Court Must Include the Debt of Affiliates Liquidating in Chapter 7. *In re Carter*, No. 23-54816-JWC, 2023 WL 9103614 (Bankr. N.D. Ga. Dec. 13, 2023) (Cavender, J.).

The debtor sought relief under subchapter V and had two affiliate entities liquidating under chapter 7. The debtor owned 65% of the stock of one entity and 99% of stock in the other. The debt of the affiliates far exceeded the \$7.5 million debt limit of subchapter V. The United States trustee filed an objection, arguing that the debtor did not meet the eligibility requirements of subchapter V under § 1182. The debtor, however, argued that the other two entities are not affiliates under § 101(2) because the "voting securities" were turned over to the chapter 7 trustees in the two other bankruptcy cases. The debtor relied on a regulation promulgated by the SEC which states that the term "voting securities means securities the holders of which are presently entitled to vote . . . ." 17 C.F.R. § 230.45.

Judge Cavender focused on the plain language of § 1182 which states that the aggregate debt of affiliates must be considered for subchapter V eligibility. He also stated that he found no cases suggesting that an owner of more than 20% of a debtor's securities ceases to be an affiliate upon appointment of a chapter 7 trustee. Judge Cavender was also not convinced that the debtor lacked the authority to vote the affiliate shares even if the SEC definition applied. Addressing policy concerns, the court determined that debtors with affiliates with debt exceeding the subchapter V limits are likely not the debtors for which subchapter V was created. The court also expressed concern that the definition of affiliate proposed by the debtor would unduly affect other parts of the Code where the term is used.

BBB. Debtor Can Use Opt-Out Provision to Get Consent for Third-Party Releases. *In re Robertshaw US Holding Corp.*, -- B.R. --, No. 24-90052, 2024 WL 3897812 (Bankr. S.D. Tex. Aug. 16, 2024).

Debtor Robertshaw makes products for various household appliances. Robertshaw filed bankruptcy after experiencing significant supply chain issues and increased costs. Meanwhile, the debtor was feuding with certain lenders and an investor. Various entities objected to confirmation, but the parties resolved most of their

objections prior to the confirmation hearing. Judge Lopez overruled one lender's four remaining objections before turning to the U.S. Trustee's objections.

The U.S. Trustee was the only party to object to the inclusion of the third-party releases in Robertshaw's plan. Specifically, the U.S. Trustee took issue with the inclusion of an opt-out provision in the debtor's plan which provided that if a creditor did not check a box to opt-out, the creditor "will be deemed to consent to the releases . . . ." The U.S. Trustee took the position that creditors should be asked to opt-in if they consent to the releases and that consent cannot be obtained by creditors not checking a box or failing to timely submit their ballot. The U.S. Trustee also argued the opt-out provision was coercive.

Judge Lopez disagreed. He emphasized that here the releases are consensual because creditors were afforded due process and had adequate notice to opt-out if they chose to do so. In fact, he noted that over 100 creditors opted out. Judge Lopez highlighted that the *Purdue* decision left open the issue of consensual releases and what constitutes consent. Because the Supreme Court left this issue open, Judge Lopez reasoned, Fifth Circuit precedent on opt-out provisions was unaffected by the *Purdue* decision. And before *Purdue* in the Fifth Circuit, courts routinely permitted consensual releases with opt-out provisions despite not allowing nonconsensual third-party releases.

Judge Lopez also discussed how the debtor presented unrefuted evidence that the releases were integral to the development of the debtor's restructuring support agreement and integral to the plan. Thus, Judge Lopez overruled the U.S. Trustee's objection and confirmed Robertshaw's plan.

Similarly, in a 2023 opinion, Judge Goldblatt of the District of Delaware concluded that "so long as the disclosure is prominent and conspicuous, and impaired creditors are given the ability to opt out simply by marking their ballot or by some other comparable device, it is appropriate to infer consent from a creditor's failure to opt out." *In re Arsenal Intermediate Holdings*, *LLC*, Case No. 23-10097, 2023 WL 2655592 (Bankr. D. Del. Mar. 27, 2023).

CCC. Purdue Pharma Does Not Prevent Bankruptcy Courts from Enjoining Litigation Against Nondebtors. In re Parlement Techs., Inc., 661 B.R. 722 (Bankr. D. Del. 2024) (Goldblatt, J.); Coast to Coast Leasing, LLC v. M&T Equip. Fin. Corp. (Coast to Coast Leasing, LLC), 661 B.R. 621 (Bankr. N.D. Ill. 2024) (Cox, J.).

In *Purdue Pharma*, the Supreme Court left open whether courts can preliminarily enjoin litigation against nondebtors. In a pair of bankruptcy court cases, both judges determined that bankruptcy courts can still grant preliminary injunctions protecting nondebtors assisting with the debtor's reorganization.

In *Parlement Technologies*, the debtor operated a conservative social media site named Parler. A former executive sued the debtor as well as several owners and former executives alleging that there was a conspiracy to deprive him of his ownership rights to the company. The debtor indemnified many of the codefendants. The automatic stay paused the litigation against the debtor, and the debtor sought to extend the automatic stay to the indemnified co-defendants. The debtor argued that a claim against an indemnified co-defendant was essentially a claim against it. The debtor further asserted that the debtor having to comply with discovery requests in the cases against the non-debtors would affect its ability to confirm a plan.

The court determined the *Purdue Pharma* decision should be confined to the question presented, which related to a third-party release—not a preliminary injunction. Thus, Judge Goldblatt concluded *Purdue* does not prevent the court from granting a preliminary injunction. He, however, determined that the test for whether a preliminary injunction is appropriate should be viewed differently in light of *Purdue*. The traditional test for a preliminary injunction requires courts to determine whether the movant has a possibility of success on the merits. Before *Purdue*, when courts considered the "possibility of success on the merits" factor, they would sometimes analyze whether the movant has a possibility of receiving a permanent injunction. After *Purdue*, courts cannot grant third-party releases or permanent injunctions. Judge Goldblatt, therefore, concluded that a "likelihood of success on the merits" in this context must mean the "likelihood of a successful reorganization" for the debtor.

Turning to the merits, the court determined that the debtor did not meet its burden of establishing the propriety of a preliminary injunction.

In *In re Coast to Coast Leasing*, the debtor wanted to enjoin litigation against its principals. Judge Cox agreed with Judge Goldblatt that *Purdue* does not preclude bankruptcy courts from enjoining litigation against nondebtors. Judge Cox also agreed that when demonstrating a likelihood of success on the merits, the debtor must show a probability of a successful reorganization—not a likelihood of receiving a permanent injunction.

Judge Cox held that the debtor in this case met its burden of establishing the propriety of a preliminary injunction.

### DDD. Section 1325(b)(1) Applies to Post-Confirmation Modified Plans. In re Halwachs, 660 B.R. 676 (Bankr. S.D. Ill. 2024) (Grandy, J.).

Throughout her chapter 13 case, the debtor proposed several plans. Each plan provided a 100% dividend to unsecured creditors but at no time during the plan did the debtor commit all her projected monthly disposable income. The court confirmed

each plan until the debtor retired from her job and proposed a new amended plan to cure a delinquency. The plan drastically decreased her payment and would pay nothing to unsecured creditors. The trustee objected, arguing that the debtor had made enough income during her plan to pay 100% to unsecured creditors, and her new amended plan violated § 1325(b)(1) because it failed to commit all of the debtor's projected monthly disposable income or pay 100% to creditors.

Section 1325(b)(1) requires a chapter 13 debtor to either pay 100% to unsecured creditors or pay all her projected disposable income throughout the duration of the plan. Section 1329(b)(1), which governs post-confirmation plan modification, says that §§ 1322(a), 1322(b), 1323(a), and 1325(a) apply to any post-confirmation modifications, but § 1329(b)(1) noticeably does not mention § 1325(b)(1). Judge Grandy acknowledged that there is split in authority over whether § 1325(b)(1)'s requirements apply to modified plans under § 1329(b)(1). Some courts have concluded that because § 1329(b)(1) does not cross-reference § 1325(b), § 1325(b)(1) must not apply to post-confirmation modification. Other courts, however, have determined that because § 1325(a), is cross-referenced in § 1329(b)(1), § 1329(b)(1) implicitly incorporates the requirements of § 1325(b)(1). Judge Grandy was persuaded by the latter argument. She agreed that § 1329(b)(1) implicitly incorporated the applicable commitment period requirement of § 1325(b)(1). She reasoned that if § 1325(b)(1) were not applicable to modifications then a debtor could propose a plan complying with § 1325(b)(1), then modify her plan to avoid compliance with § 1325(b)(1)—"render[ing] the disposable income test and applicable commitment periods a fleeting nullity." Lastly, she discussed how application of § 1325(b)(1) to plan modifications was consistent with the legislative intent of BAPCPA to limit judicial discretion in payment amounts and maximize recovery for unsecured creditors.

After concluding that § 1325(b)(1) applied to post-confirmation plan modifications, the court sustained the trustee's objection to confirmation because, based on the debtor's testimony, the court concluded she failed to commit her disposable income throughout her plan.

EEE. Social Security Administration's Reduction in Disability Payments to Recover a Previous Overpayment was a Setoff and Did Not Establish Recoupment as Defense to Discharge Violation. Edwards v. O'Malley (In re Edwards), 659 B.R. 24 (Bankr. D.N.H. 2024) (Harwood, C.J.).

A chapter 7 debtor reopened her case and filed an adversary proceeding alleging the Social Security Administration (SSA) violated the discharge injunction by reducing her current post-discharge disability payments (based on a claim of disability filed in 2021) to recover an overpayment of benefits to her between 2007 and 2010 (based

on a separate disability claim). The debtor argued that the SSA's reduction of the debtor's post-discharge benefits was a setoff that violated the discharge injunction. The SSA argued the reduction constituted recoupment, which was not barred by the bankruptcy discharge. The bankruptcy court recognized that the "analysis of the recoupment issue should both begin and end with the same transaction question without discussing other equitable issues." It found that SSA's actions did not arise out of a "single, ongoing, and integrated transaction" and held that the attempted recovery was a setoff rather than a recoupment. "The mere fact that 'the same parties and subject matter are involved does not mean the claims arose from the same transaction." Accordingly, the bankruptcy court denied SSA's motion for judgment on the pleadings, finding that SSA did not establish a defense to the alleged discharge injunction violation.

FFF. If Confirmed Plan Is Non-Consensual, § 523(a)(2) Discharge Exception Applies to Non-Individual Subchapter V Debtors. *Ivanov v. Van's Aircraft, Inc. (In re Van's Aircraft, Inc.)*, No. 23-62260, Adv. No. 24-06011-dwh, 2024 WL 2947601 (Bankr. D. Or. June 11, 2024) (Hercher, J.).

A plaintiff brought an adversary proceeding against the corporate debtor in a subchapter V case, alleging claims for breach of contract and seeking an exception to discharge determination under section 523(a)(2) based on allegedly fraudulent misrepresentations in connection with the same contract. The debtor moved to dismiss both claims, arguing that § 523 does not apply to a nonindividual subchapter V debtor.

The bankruptcy court disagreed. Siding with results reached in the Fourth and Fifth Circuits and disagreeing with the Ninth Circuit BAP (despite sitting in the Ninth Circuit) in *Lafferty v. Off/Spec Sols. LLD (In re Off-Spec Sols. LLC)*, 651 B.R. 862 (B.A.P. 9th Cir. 2023), the bankruptcy court concluded that "the plain meaning of 1192(2) is that the discharge under a subchapter V plan confirmed nonconsensually excepts the debts listed in the 523(a) debt-type list—even when the debtor is not an individual."

GGG. Bankruptcy Code Authorizes Bankruptcy Courts to Grant Creditors' Committees Derivative Standing to Assert Bankruptcy Estate Claims Despite State Law Limitations on Derivative Actions. *In re Pack Liquidating, LLC*, 658 B.R. 305 (Bankr. D. Del. 2024) (Goldblatt, J.).

The official committee of unsecured creditors filed an adversary proceeding against corporate debtor's insiders, asserting claims for equitable subordination, avoidance and recovery of alleged fraudulent conveyances as well as the disallowance of claims

based on allegations of mismanagement and self-dealing. Some of the defendants objected to the committee's motion for derivative standing with respect to its claim for breach of fiduciary duty on behalf of the bankruptcy estate. The defendants argued that the committee could not be granted derivative standing to pursue the claim because Delaware state law provides that only the members of an LLC or the company's assignees may be granted derivative standing to act on behalf of the company.

The bankruptcy court disagreed, concluding that the authority to grant a committee derivative standing to pursue an estate claim stems from the Bankruptcy Code rather than state law.

HHH. Corporate Subchapter V Debtors Cannot Discharge § 523(a) Debts. Christopher Glass & Aluminum, Inc. v. Premier Glass Servs., LLC (In re Premier Glass Servs., LLC), 661 B.R. 939 (Bankr. N.D. Ill. 2024) (Thorne, J.).

The debtor's principal previously worked for the plaintiff. The plaintiff alleged, among other things, that the debtor's principal deliberately violated his noncompete agreement. Plaintiff sued the principal and the debtor. After the parties arbitrated these claims but before the arbitrator's findings could be approved by a state court, the debtor filed a bankruptcy petition under subchapter V. The plaintiff sought a determination that the debts it is owed stem from malice and are, therefore, nondischargeable under § 1192(2). The debtor argues that § 1192(2) does not prevent a subchapter V corporate debtor from discharging debts stemming from the debtor's malicious conduct because § 1192(2) only creates exceptions to discharge for individual subchapter V debtors.

Section 1192(2) provides that a subchapter V debtor cannot discharge any debts "of a kind specified in section 523(a)." Section 523(a) provides that discharge under the Code does not discharge "an individual debtor" from certain debts including § 523(a)(6)'s exception to discharge "for willful and malicious injury by the debtor to another entity or to the property of another entity." Judge Thorne noted that courts are split over whether § 523(a)'s exceptions to discharge only apply to individual subchapter V debtors. Judge Thorne, however, emphasized that § 1192(2) only refers to the types of debt listed under § 523(a) and does not refer to whether the debtor is an individual or entity. Thus, she concluded that § 1192(2) does not require the court to consider the type of debtor, just whether the type of debt is excepted from discharge under § 523(a). She compared the language of § 1192(2) to § 1228(a), an almost identical provision in chapter 12. Courts have determined that § 1228(a) incorporates § 523(a)'s exceptions to discharge for individual and entity debtors. Judge Thorne concluded, § 1192(2) should be interpreted similarly. Lastly, she rejected the debtor's argument that § 1192(2) is ambiguous and that she should

follow the majority of bankruptcy courts by limiting  $\S 523(a)$ 's exceptions to discharge to individual subchapter V debtors. She reiterated that the text of  $\S 1192(2)$  clearly refers to the types of debt in  $\S 523(a)$  and pays no mind to the type of debtor.

## **Faculty**

Hon. Shon K. Hastings is Chief U.S. Bankruptcy Judge for the District of North Dakota in Fargo, appointed in September 2011. She is also designated to preside over bankruptcy cases in the Districts of South Dakota and Minnesota. From 2014-21, she was assigned bankruptcy cases in the District of Nebraska. Judge Hastings serves as a mediator for civil cases in the U.S. District Court for the District of North Dakota and bankruptcy cases in the District of Minnesota. She also has mediated bankruptcy cases in the Northern and Southern Districts of Iowa. In January 2022, she was appointed to the Bankruptcy Appellate Panel of the Eighth Circuit. She began serving as Chief Judge of the Eighth Circuit Bankruptcy Appellate Panel on Jan. 25, 2024. Prior to her appointment, Judge Hastings served as a federal judicial law clerk for two years, associate attorney for Bowman and Brook LLP in Minneapolis for several years and Assistant U.S. Attorney in Fargo for almost 14 years. She received her undergraduate degree and J.D. from the University of North Dakota.

**Hon. Dale L. Somers** is Chief U.S. Bankruptcy Judge for the District of Kansas in Topeka, initially appointed in September 2003. He hears cases in Topeka, Kansas City and Wichita. Previously, he was in private practice for 32 years and a partner in the law firms of Eidson, Lewis, Porter & Haynes and Wright, Henson, Somers, Sebelius, Clark & Baker. Judge Somers was appointed to the Bankruptcy Appellate Panel for the U.S. Court of Appeals for the Tenth Circuit in March 2010. He served as a member of the Judicial Resources Committee of the Judicial Conference of the United States. Judge Somers served on the Board of Governors for the Kansas Bar Association from 1988-98 and as president from 1995-96. He is a Fellow of the of the American College of Bankruptcy and of the American Bar Association. Judge Somers received his undergraduate degree from Kansas State University in 1968 and his J.D. from the University of Kansas School of Law in 1971.

**Hon. Brian C. Walsh** is a U.S. Bankruptcy Judge for the Eastern District of Missouri in ??, appointed in January 2023. Before taking the bench, he practiced for more than 25 years in Atlanta and St. Louis, principally in bankruptcy, restructuring and related fields. Judge Walsh is a Fellow of the American College of Bankruptcy and began his legal career in Kansas City clerking for Judge Pasco Bowman of the U.S. Court of Appeals for the Eighth Circuit. He received his undergraduate degree from Duke University and his J.D. from Harvard Law School.