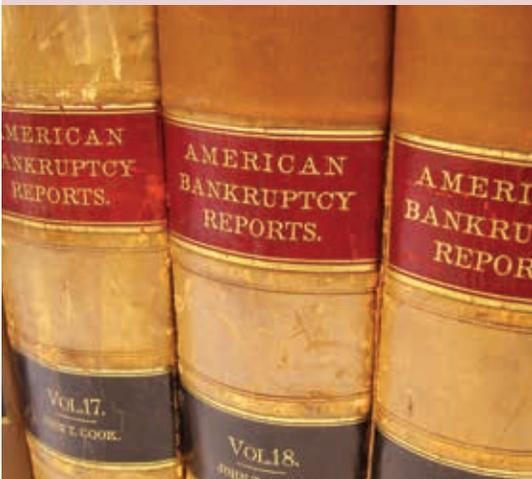


Oregon  
State  
Bar

CLE  
Seminars

# ***35th Annual*** **Northwest Bankruptcy Institute**



*Cosponsored by the  
WSBA Creditor Debtor Rights Section and  
the OSB Debtor-Creditor Section*

Thursday, May 12, 2022

8:30 a.m.–5 p.m.

Friday, May 13, 2022

9 a.m.–Noon

Oregon: 8.75 General CLE credits and  
1 Ethics credit (ID 88461)

Washington: 7.5 Law & Legal Procedure  
credits and 1 Ethics credit (ID 1206373)

# 35TH ANNUAL NORTHWEST BANKRUPTCY INSTITUTE

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## SCHEDULE

Thursday, May 12, 2022

**7:30 Registration/Buffer Breakfast**

**8:30 The Outlook for the Economy and Bankruptcy Filings**

William Rule, *Judicial Services Office, Administrative Office of the U.S. Courts, Washington, D.C.*

**9:15 Select Exemptions Review: Washington Homestead and Oregon Personal Property**

Stephen Gindling, *Todd Trierweiler & Associates, Portland*

Christina Henry, *Henry & DeGraaff PS, Seattle*

**10:00 Break**

**10:15 The Outer Limits of Bankruptcy: Third-Party Releases and the “Texas Two-Step”**

Moderator: Oren Haker, *Stoel Rives LLP, Portland*

Professor Andrea Coles-Bjerre, *University of Oregon School of Law, Eugene*

Professor Aaron Simowitz, *Willamette University College of Law, Salem*

**11:30 Lunch**

**12:30 Evidentiary Issues in Bankruptcy Cases: Objections and Opportunities**

Susan Ford, *Sussman Shank LLP, Portland*

Holly Hayman, *Farleigh Wada Witt, Portland*

Binah Yeung, *Cairncross & Hempelmann PS, Seattle*

**1:30 Ethics 101: Recent Lessons for Bankruptcy Lawyers and Judges**

Professor Laurie Levenson, *Loyola Law School, Los Angeles*

**2:30 Break**

**2:45 Ninth Circuit Case Review**

The Honorable Whitman Holt, *U.S. Bankruptcy Court, Eastern District of Washington, Yakima*

Catherine Devlin, *U.S. Bankruptcy Court, District of Oregon, Portland*

Michael Rogers, *U.S. Bankruptcy Court, Western District of Washington, Tacoma*

**3:45 Judges Panel**

Moderator: The Honorable David Hercher, *U.S. Bankruptcy Court, District of Oregon, Portland*

The Honorable Whitman Holt, *U.S. Bankruptcy Court, Eastern District of Washington, Yakima*

The Honorable Brian Lynch, *U.S. Bankruptcy Court, Western District of Washington, Tacoma*

The Honorable Teresa Pearson, *U.S. Bankruptcy Court, District of Oregon, Portland*

**5:00 Adjourn to Hosted Reception**

**6:00 WSBA Creditor Debtor Rights Section Executive Committee meeting**

## SCHEDULE (Continued)

Friday, May 13, 2022

**8:30 Breakfast Buffet**

**9:00 Restructuring Challenges Facing Skilled Nursing and Assisted Living Facilities in Chapter 11: What Are They and How Do We Solve Them?**

Francis Lawall, *Troutman Pepper, Philadelphia*

Cynthia Nelson, *FTI Consulting, Los Angeles*

**10:00 The Federal Forfeiture Process**

Katie de Villiers, *Asset Recovery & Money Laundering Division, U.S. Attorney's Office, Portland*

**10:45 Break**

**11:00 Married . . . But Single: Filing in Oregon and Washington**

Deborah Crabbe, *Foster Garvey, Seattle*

Gerald Pederson, *Todd Trierweiler & Associates, Portland*

**12:00 Adjourn**

## FACULTY

**Professor Andrea Coles-Bjerre**, *University of Oregon School of Law, Eugene*. Professor Coles-Bjerre is Associate Professor of Law at the University of Oregon School of Law, specializing in bankruptcy law, and is also Faculty Director of the UO's Business Law Program. She has received the Orlando J. Hollis Award for Excellence in Teaching. She is the author of the Bankruptcy chapter of Powell on Real Property and was recently a Visiting Fellow at the Commercial Law Centre of the University of Oxford.

**Deborah Crabbe**, *Foster Garvey, Seattle*. Ms. Crabbe focuses on representing creditors in all aspects of secured transactions, receiverships, bankruptcies, and workout proceedings. In particular, she has substantial experience representing lenders, leasing companies, trade creditors, trustees, and receivers. She is a Trustee of the American Bankruptcy Institute and a member of the King County Bar Association, the Oregon State Bar Debtor-Creditor Section, and the Washington State Bar Association Creditor Debtor Rights Section. She is admitted to practice in Washington and Oregon.

**Katie de Villiers**, *Asset Recovery & Money Laundering Division, U.S. Attorney's Office, Portland*. Ms. de Villiers serves as the Chief of the Asset Recovery & Money Laundering Division. She is a frequent instructor at forfeiture, restitution, and financial investigation courses for federal agents and attorneys with the U.S. Department of Justice.

**Catherine Devlin**, *U.S. Bankruptcy Court, District of Oregon, Portland*. Ms. Devlin is a bankruptcy law clerk for the Honorable Peter C. McKittrick. Previously, she was a law clerk at the Washington State Court of Appeals in Seattle for the Honorable David S. Mann.

**Susan Ford**, *Sussman Shank LLP, Portland*. Ms. Ford focuses her practice on resolving complex business problems for clients, both in and out of the courtroom. She is the immediate past chair of the firm's Business Restructuring and Bankruptcy Group. She specializes in Chapter 11 reorganizations, liquidations, and receiverships. She has represented all types of parties involved in restructuring situations, receiverships, Chapter 11 reorganizations, and liquidations, including debtors, state and federal court receivers, creditors' committees, secured lenders, unsecured creditors, trustees, and asset purchasers. She has served as chair of the Oregon State Bar Debtor-Creditor Section and as a board member and officer of the Turnaround Management Association Northwest Chapter. She is a regular speaker and moderator at continuing legal education programs and volunteers at the Oregon Legal Aid Bankruptcy Clinic. Ms. Ford is the 2018 recipient of the Oregon State Bar Debtor-Creditor Section William N. Stiles Award of Merit. Ms. Ford is admitted to practice in Oregon and Washington.

**Stephen Gindling**, *Todd Trierweiler & Associates, Portland*. Mr. Gindling currently focuses his practice on Oregon Chapter 13 cases. He has represented thousands of debtors in Chapter 7 and Chapter 13 cases since 2001. He has litigated stay violations, valuation issues, dischargeability challenges, and claim validity. He has also argued before the Ninth Circuit Court of Appeals Bankruptcy Appellate Panel. He also has represented secured and unsecured creditors and bankruptcy trustees in state and federal courts. He is admitted to practice in Oregon and Washington.

**Oren Haker**, *Stoel Rives LLP, Portland*. Mr. Haker focuses on the representation of a wide range of parties in workouts, debt restructurings, receiverships, and bankruptcy cases, including corporate debtors, trade and financial creditors, creditors' committees, lessors, and strategic and financial investors acquiring assets of troubled companies. During the 2008 financial crisis, Mr. Haker was a member of the legal team advising President Obama's Auto Task Force in the General Motors, Chrysler, and Delphi Automotive Chapter 11 cases. Mr. Haker is admitted to practice in Oregon, New York, and Washington.

## FACULTY (Continued)

**Holly Hayman, Farleigh Wada Witt, Portland.** Ms. Hayman has a diverse practice that includes representing creditors, bankruptcy trustees, and other stakeholders in bankruptcy, federal, and state courts. She also counsels business clients and fiduciaries on transactional matters. She is active in several bar organizations, including the OSB Debtor-Creditor Section, the Multnomah Bar Association, and Oregon Women Lawyers. Ms. Hayman also represents low-income Oregonians on a pro bono basis through the Legal Aid Services of Oregon Bankruptcy Clinic.

**Christina Henry, Henry & DeGraaff PS, Seattle.** Ms. Henry advocates for clients against predatory lenders and unfair debt collection practices. She has taken a leading role in consumer litigation in Seattle and the surrounding region, focusing on private student loans, mortgage modification, “zombie loans,” automatic stay violations, and discharge injunction violations. She also represents consumer and small business debtors in Chapter 7, 13, and 11 bankruptcy cases and negotiates debt with creditors when the process better serves her clients.

**The Honorable David Hercher, U.S. Bankruptcy Court, District of Oregon, Portland.**

**The Honorable Whitman Holt, U.S. Bankruptcy Court, Eastern District of Washington, Yakima.** Judge Holt has served as a United States Bankruptcy Judge for the Eastern District of Washington since November 1, 2019. Before taking the bench, Judge Holt was a partner in a Los Angeles firm, where his bankruptcy practice included briefing multiple matters before the United States Supreme Court. Judge Holt is the coauthor (with Kenneth N. Klee) of *Bankruptcy and the Supreme Court: 1801–2014* (West Academic 2015) and of a series of commentaries about bankruptcy and the Supreme Court for the LexisNexis Emerging Issues Analysis project. Judge Holt also is a contributing author for the *Collier on Bankruptcy* treatise and related standalone publications. Judge Holt is a Conferee of the National Bankruptcy Conference, which is an invitation-only organization dedicated to advising Congress about the operation of bankruptcy and related laws.

**Francis Lawall, Troutman Pepper, Philadelphia.** Mr. Lawall is a partner in the firm’s Corporate Restructuring and Bankruptcy Practice and concentrates on national bankruptcy matters and workouts, including the representation of debtors, creditors’ committees, trustees, and examiners in various industries including healthcare and energy. He also has substantial complex litigation and appellate experience in and outside the bankruptcy courts and routinely represents companies plagued with massive toxic tort liabilities, as well as companies in the textile, technology, automotive, clothing, and construction materials industries. He has represented numerous buyers and sellers of assets in and out of bankruptcy proceedings. Mr. Lawall has published and lectured on a variety of bankruptcy and credit issues. He writes monthly articles on current bankruptcy topics for *The Philadelphia Legal Intelligencer*. He is the lead author of *Debt Adjustments for Municipalities Under Chapter 9 of the Bankruptcy Code*, a Collier Monograph. He is coauthor of “How to Turn Around a Corporation Plagued with Mass Toxic Torts” (*Workouts & Turnarounds, The Handbook of Restructuring and Investing in Distressed Companies*), “Representing the Performance Bond Surety” (*Construction Defaults: Rights, Duties and Liabilities*), and “Identifying the Problem and Developing a Solution” (*Winning, Legal Strategies for Bankruptcy and Restructuring*).

**Professor Laurie Levenson, Loyola Law School, Los Angeles.** Professor Levenson is the David W. Burcham Chair in Ethical Advocacy. She teaches Criminal Law, Criminal Procedure, White Collar Crime, Ethical Lawyering, Evidence, and Advanced Trial Advocacy. She has been a visiting professor at UCLA School of Law and USC Law School and a D&L Straus distinguished visiting professor at Pepperdine School of Law. Professor Levenson is the Founding Director of the Loyola Project for the Innocent, the Loyola Center for Ethical Advocacy, and the Fidler Institute on Criminal Justice, and Senior Faculty for Loyola’s Journalist Law School. She serves as a Special Master for the United States District Court and Los Angeles County Superior Court. Professor Levenson is a frequent lecturer for the Federal Judicial Center and state and federal bars regarding legal ethics, wrongful convictions, and criminal procedure and legal commentator for CBS, CNN, ABC, NBC, BBC, and NPR.

## FACULTY (Continued)

**The Honorable Brian Lynch**, *U.S. Bankruptcy Court, Western District of Washington, Tacoma*. Judge Lynch was sworn in as a United States Bankruptcy Judge on June 1, 2010. He served as Chief Bankruptcy Judge of the District from October 1, 2014 to September 30, 2019 and as chair of the Conference of Ninth Circuit Chief Bankruptcy Judges in 2017. Prior to his appointment, he served as the Standing Chapter 13 Trustee for the Portland Division of the District of Oregon and as the Standing Chapter 12 Trustee for the District of Oregon. He is the 2018 recipient of the National Association of Chapter 13 Trustees Honorable Ralph Kelley Award.

**Cynthia Nelson**, *FTI Consulting, Los Angeles*. Ms. Nelson specializes in assisting stakeholders with interests in real estate in restructurings and disputes. In particular, she has expertise in connection with large-scale land development, master planned communities, retail and hospitality, among other land uses. Ms. Nelson assists clients in evaluating, developing and implementing turnaround plans and restructurings in both judicial and nonjudicial circumstances and providing litigation support and testimony in adversarial proceedings. She is a member of the Association of Insolvency & Restructuring Advisors, the American College of Bankruptcy Board of Directors, the ICSC (fka International Council of Shopping Centers), the Turnaround Management Association, and the Women's Leadership Council. Ms. Nelson is a frequent speaker at conferences and seminars. She has published articles in *Real Estate Finance Journal*, *ABI Journal*, *CPA Expert*, *Shopping Center Business*, *Daily Bankruptcy Review*, *Journal of Turnaround Management*, and *Socioeconomic Planning Sciences and Urban Land*, among other publications. She is a Certified Insolvency & Restructuring Advisor (CIRA).

**The Honorable Teresa Pearson**, *U.S. Bankruptcy Court, District of Oregon, Portland*. Judge Pearson was appointed as a U.S. Bankruptcy Judge for the District of Oregon on October 4, 2021. Prior to her appointment, her legal practice focused primarily on creditors' rights, insolvency, and reorganization. She represented secured lenders, unsecured lenders, trade creditors, creditor committees, trustees, receivers, debtors, and other clients in all forums where debtor-creditor issues appear—out of court, bankruptcy court, state and federal trial court, and appellate court. Judge Pearson had experience with all sizes of companies in a wide range of industries. She holds national board certification in business bankruptcy law from the American Board of Certification.

**Gerald Pederson**, *Todd Trierweiler & Associates, Portland*. Mr. Pederson is a member of the bar in Oregon and Washington and has argued cases before the Ninth Circuit Bankruptcy Appellate Panel.

**Michael Rogers**, *U.S. Bankruptcy Court, Western District of Washington, Tacoma*. Mr. Rogers serves as law clerk to the Honorable Mary Jo Heston, U.S. Bankruptcy Court for the Western District of Washington.

**William Rule**, *Judicial Services Office, Administrative Office of the U.S. Courts, Washington, D.C.* Dr. Rule holds a Ph.D. in economics and econometrics and serves as senior economist in the Judicial Services Office. His primary duties revolve around support of the Judicial Conference Committee on the Administration of the Bankruptcy System. In that capacity he supervises judgeship surveys to determine the need for additional bankruptcy judgeships and the continuing need for existing judgeships. Of particular interest to the nation's bankruptcy judges are the quarterly judicial workload reports he produces. He provides the committee and the Administrative Office Director's Bankruptcy Judges Advisory Group with regular updates on the state of the economy and bankruptcy filings. He has also served on a number of panels including for the ABI and the NACTT, and has given talks to bankruptcy section meetings, CLE programs, judges' meetings, the NCBJ board of governors, and circuit conferences. This latter role has earned him the nickname "Dr. Doom."

## FACULTY (Continued)

**Professor Aaron Simowitz**, *Willamette University College of Law, Salem*. Professor Simowitz is an Assistant Professor of Law and Co-Director of the Business Lawyering Institute. He teaches international business transactions, debtor and creditor law, negotiation, civil procedure, and seminars on business negotiations and on resolving business disputes. His research focuses on cross-border business transactions, litigation, and arbitration. Professor Simowitz is the chair-elect of the AALS Section on Conflict of Laws, co-director of the Willamette University Business Lawyering Institute, and an affiliated scholar with the Classical Liberal Institute at New York University. He received the Young Scholar's Award from the American Society of International Law Private International Law Interest Group for his work on judgment and award enforcement against intangible assets.

**Binah Yeung**, *Cairncross & Hempelmann PS, Seattle*. Ms. Yeung is a member of the firm's Litigation Group. Her practice involves representing clients in complex business disputes, condemnation, real estate, and general commercial litigation through the mediation, trial, and appeal process in both state and federal courts. She is a recipient of the King County Bar Association Outstanding Young Lawyer Award and the American Bankruptcy Institute Medal of Excellence. She serves as the cochair of the Mackrell International Americas Next Generation Group. Ms. Yeung is admitted to practice in Washington, Oregon, and Alaska.

## Chapter 1

# Presentation Slides: The Economy and Bankruptcy Filings

**WILLIAM RULE**

Judicial Services Office  
Administrative Office of the U.S. Courts  
Washington, D.C.



# The Economy And Bankruptcy Filings

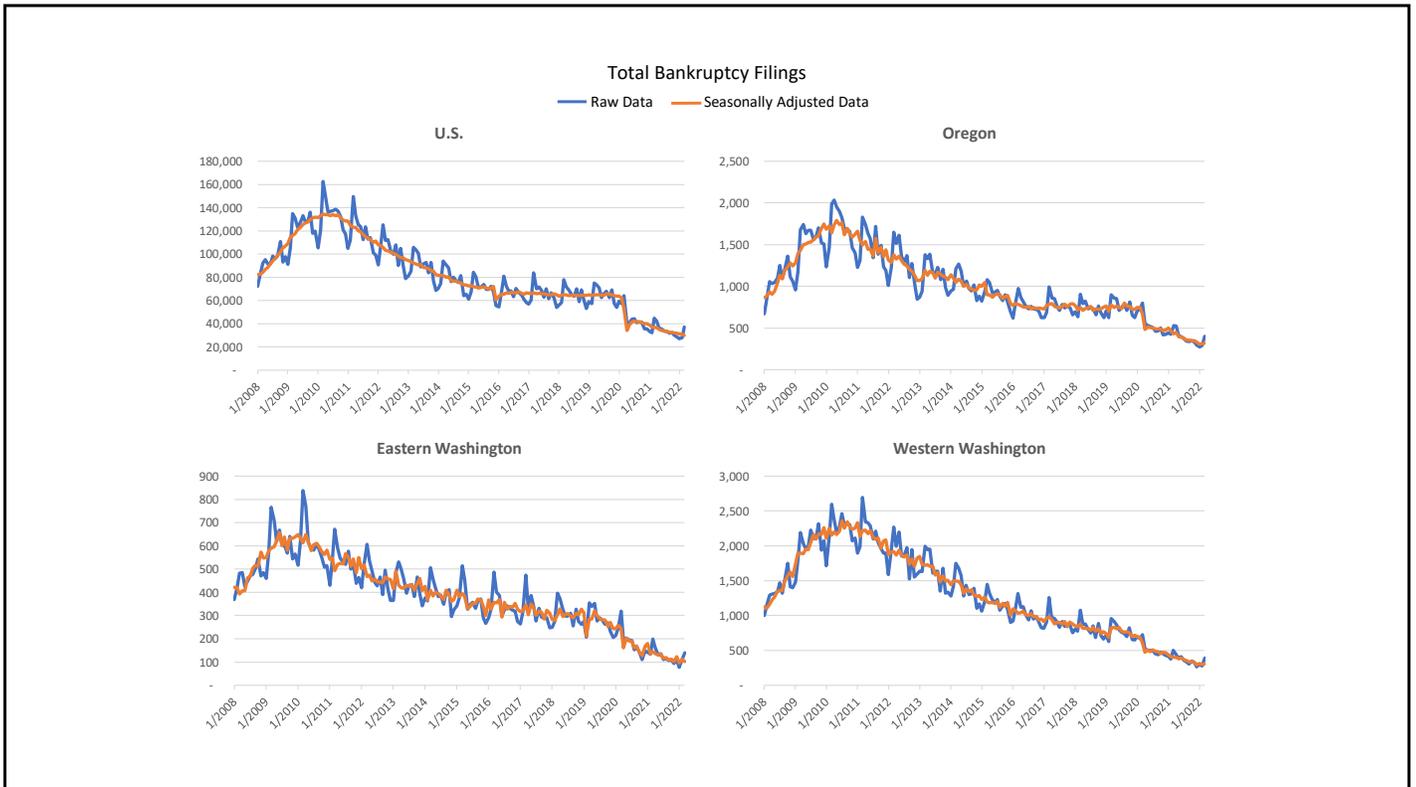
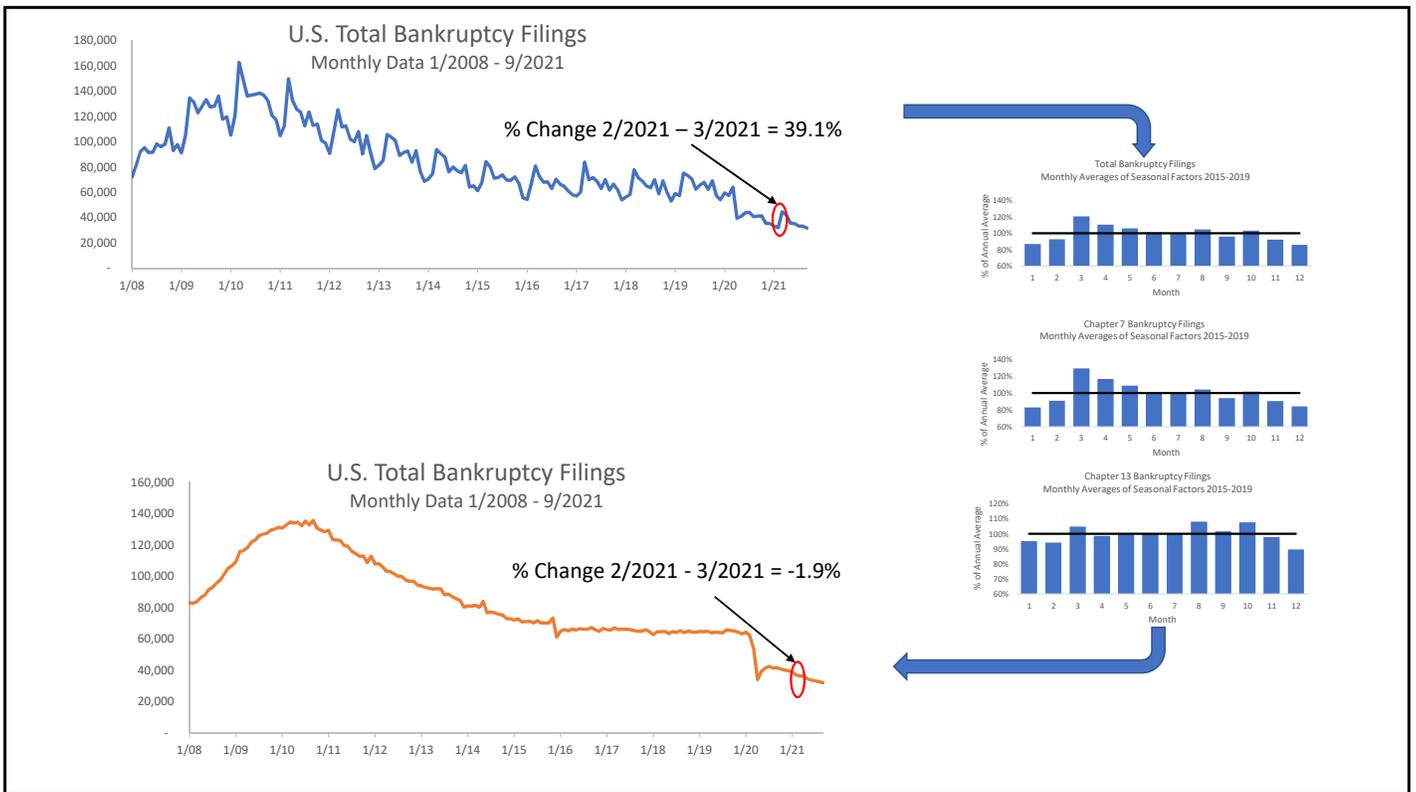
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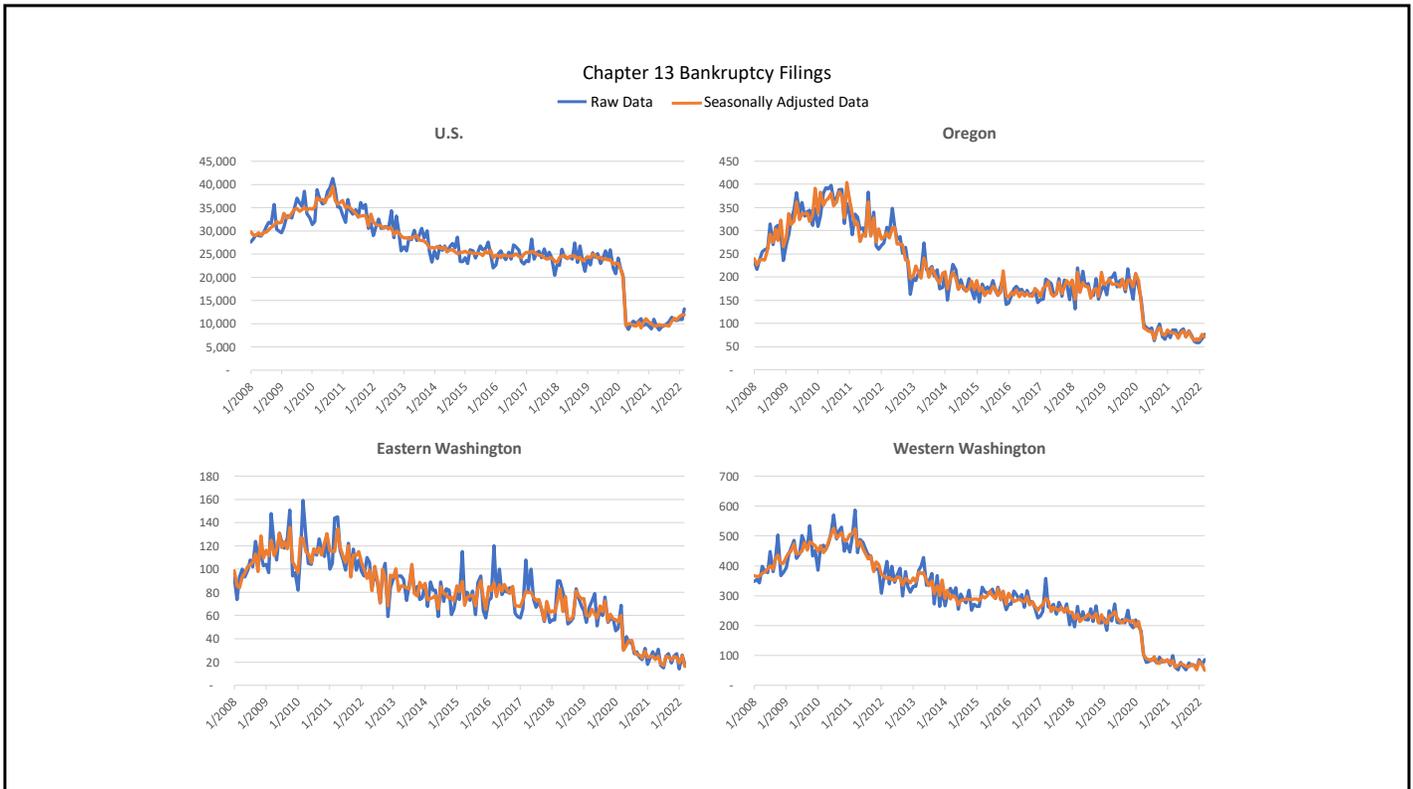
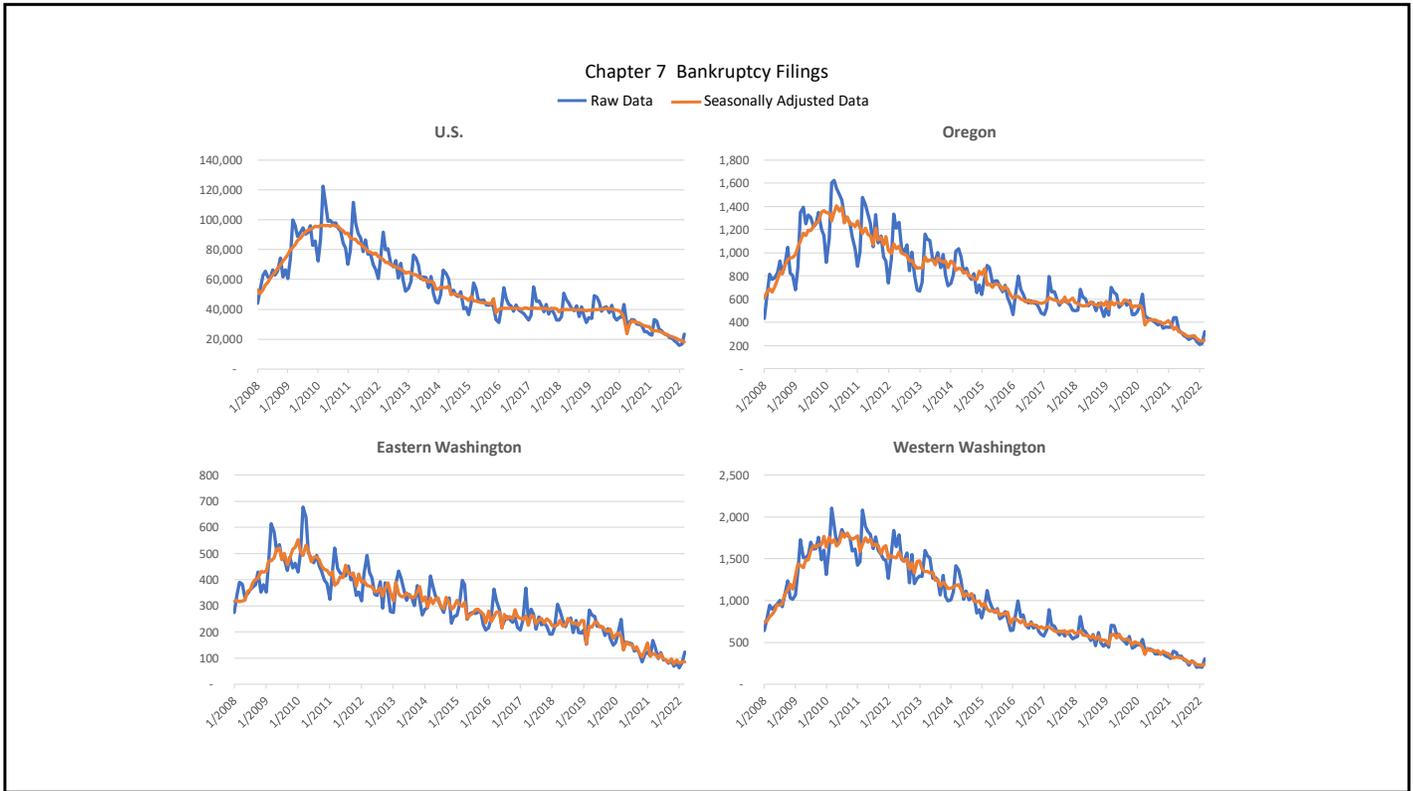


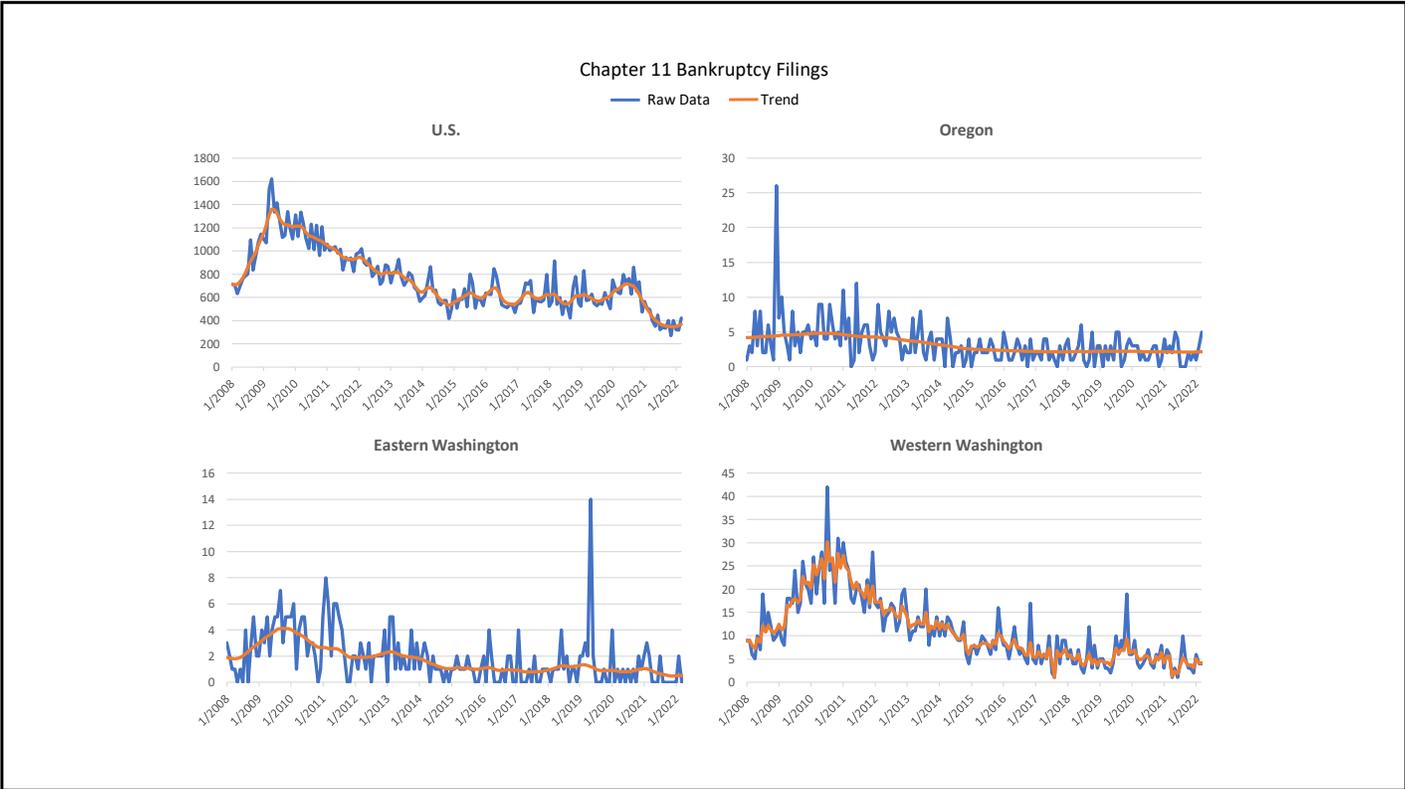
William T. Rule II, Ph.D.  
Senior Economist  
Administrative Office of the United States Courts  
May 12, 2022

# BANKRUPTCY FILINGS

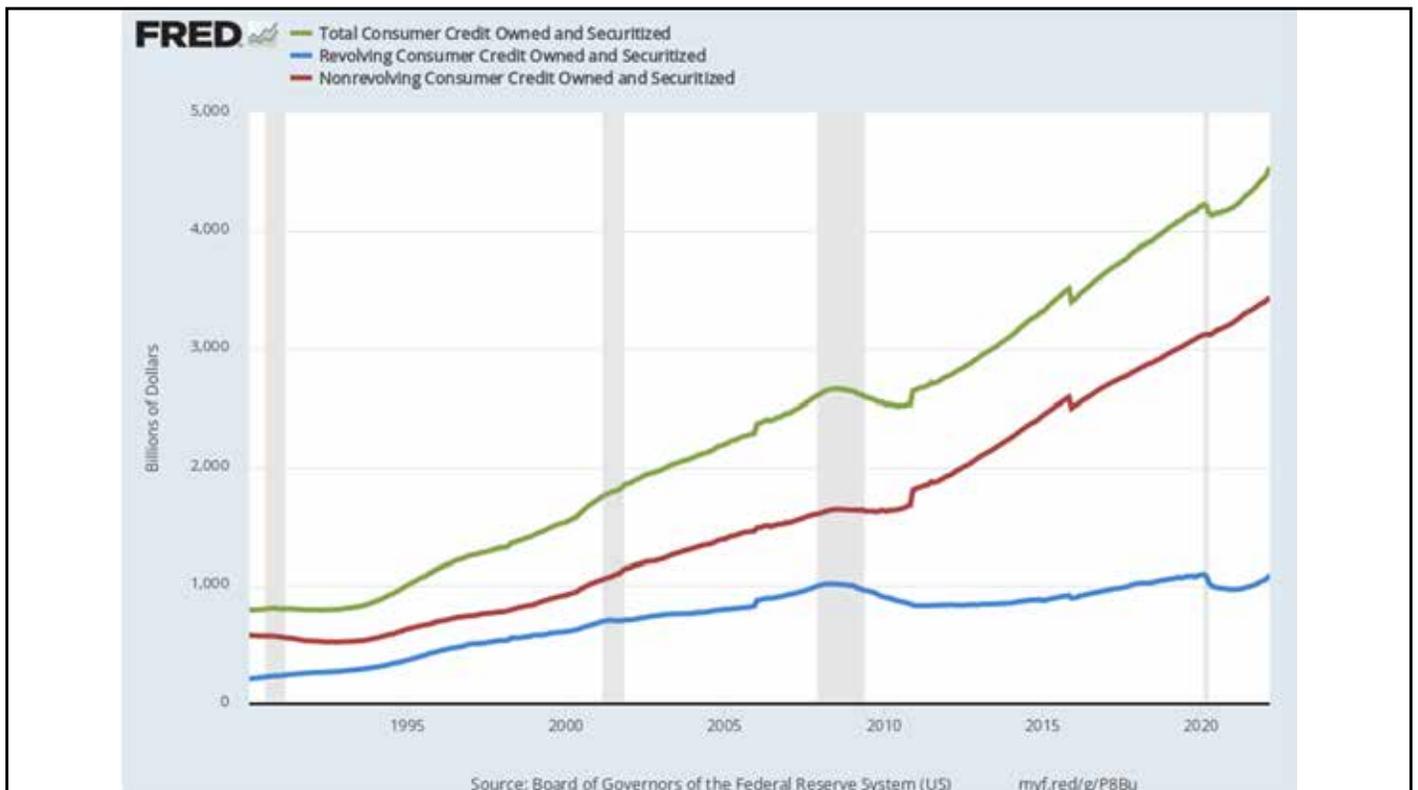
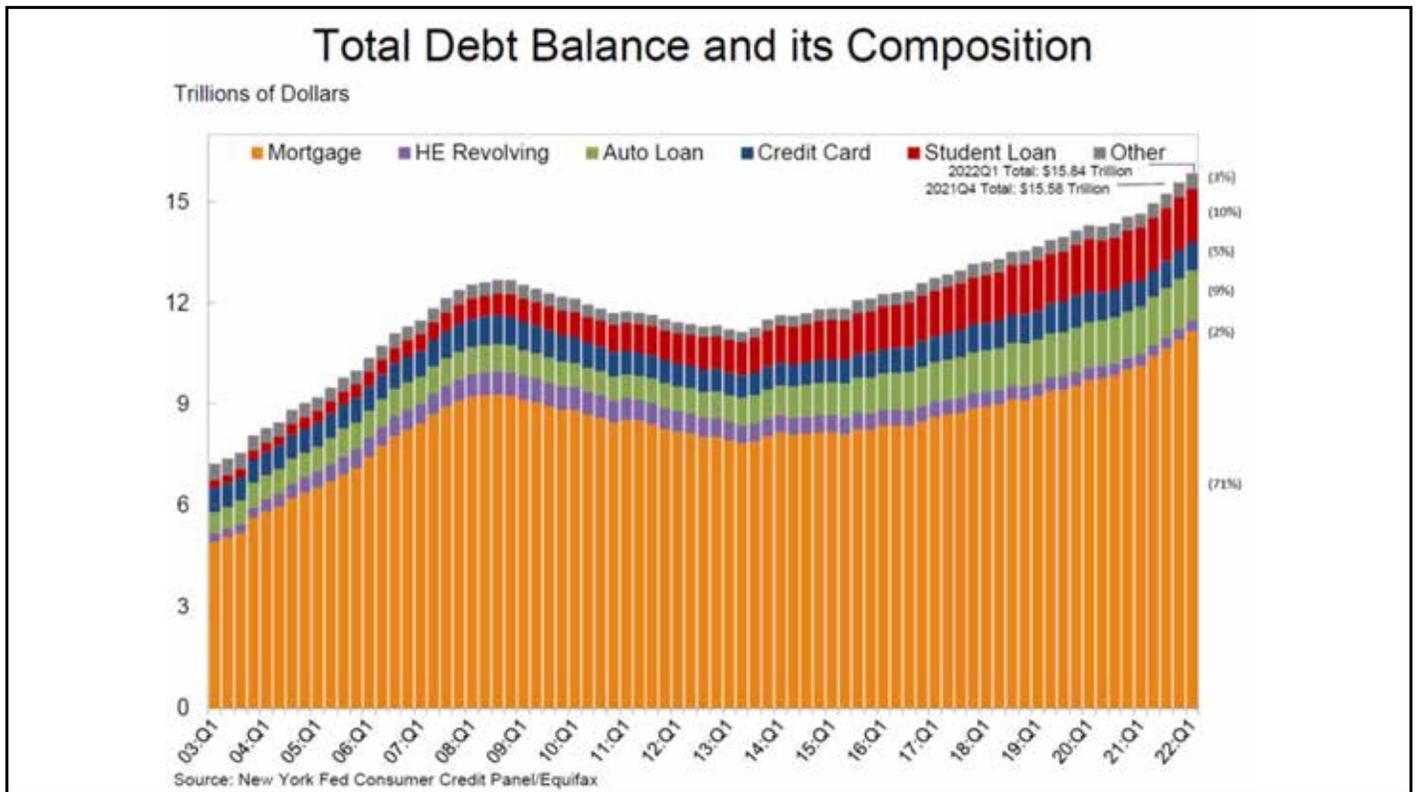
# Chapter 1—Presentation Slides: The Economy and Bankruptcy Filings

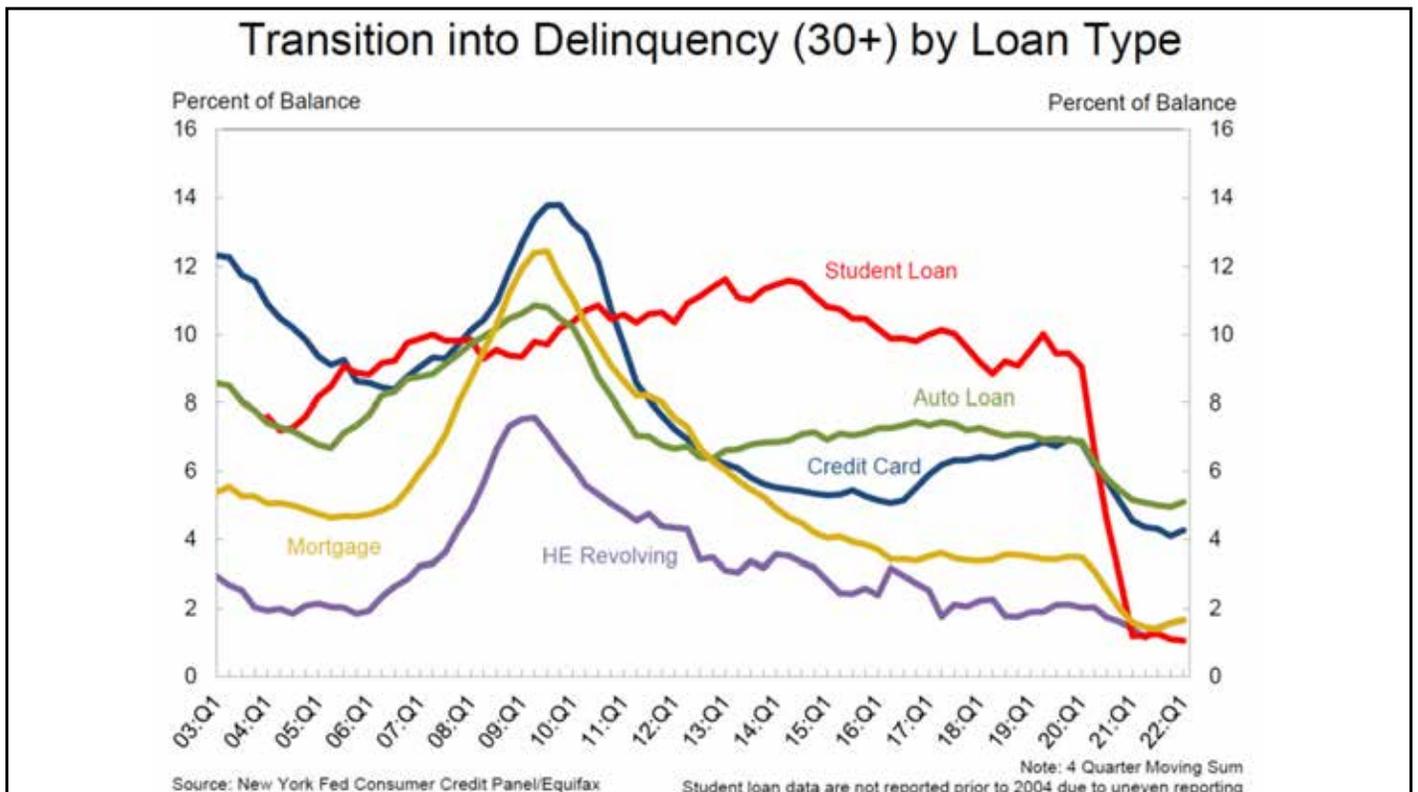
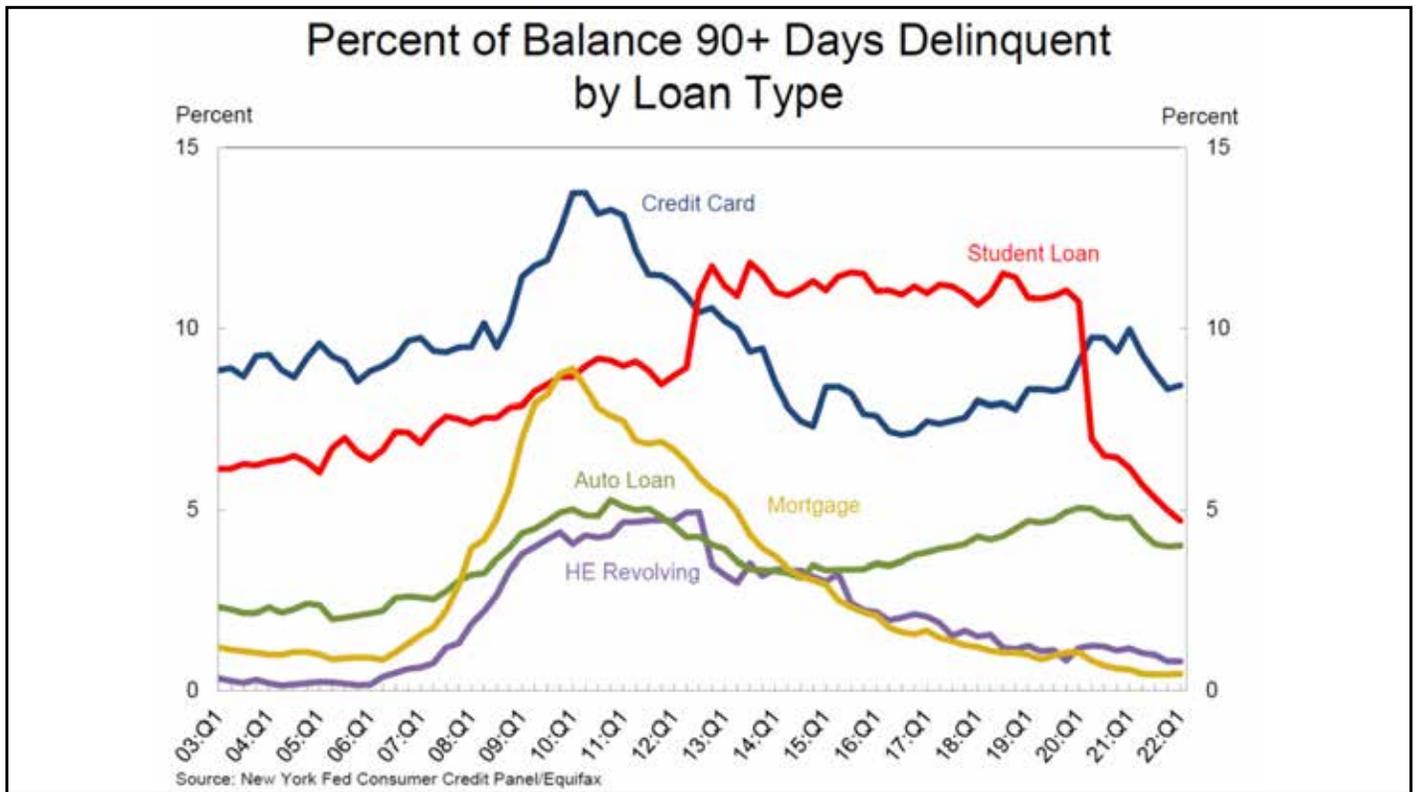


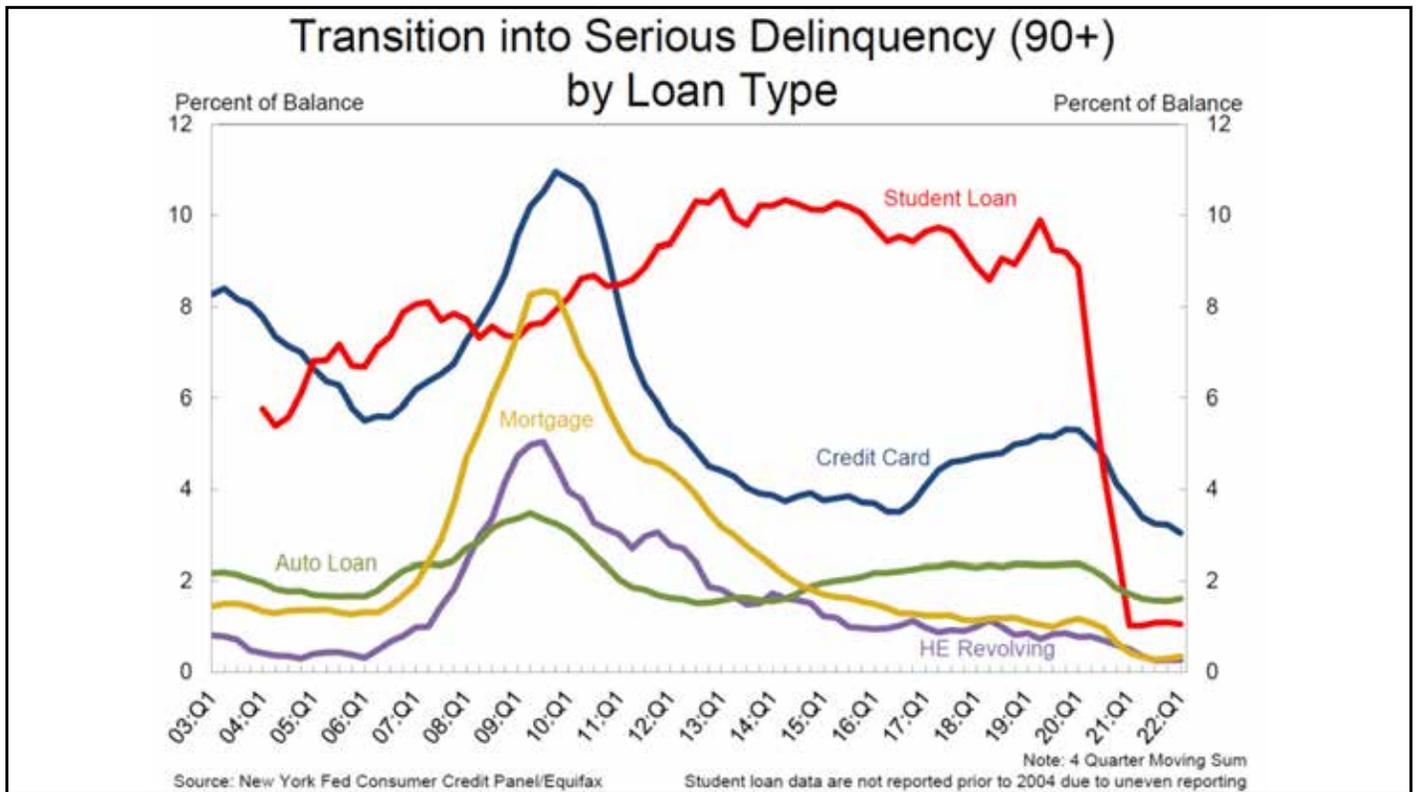




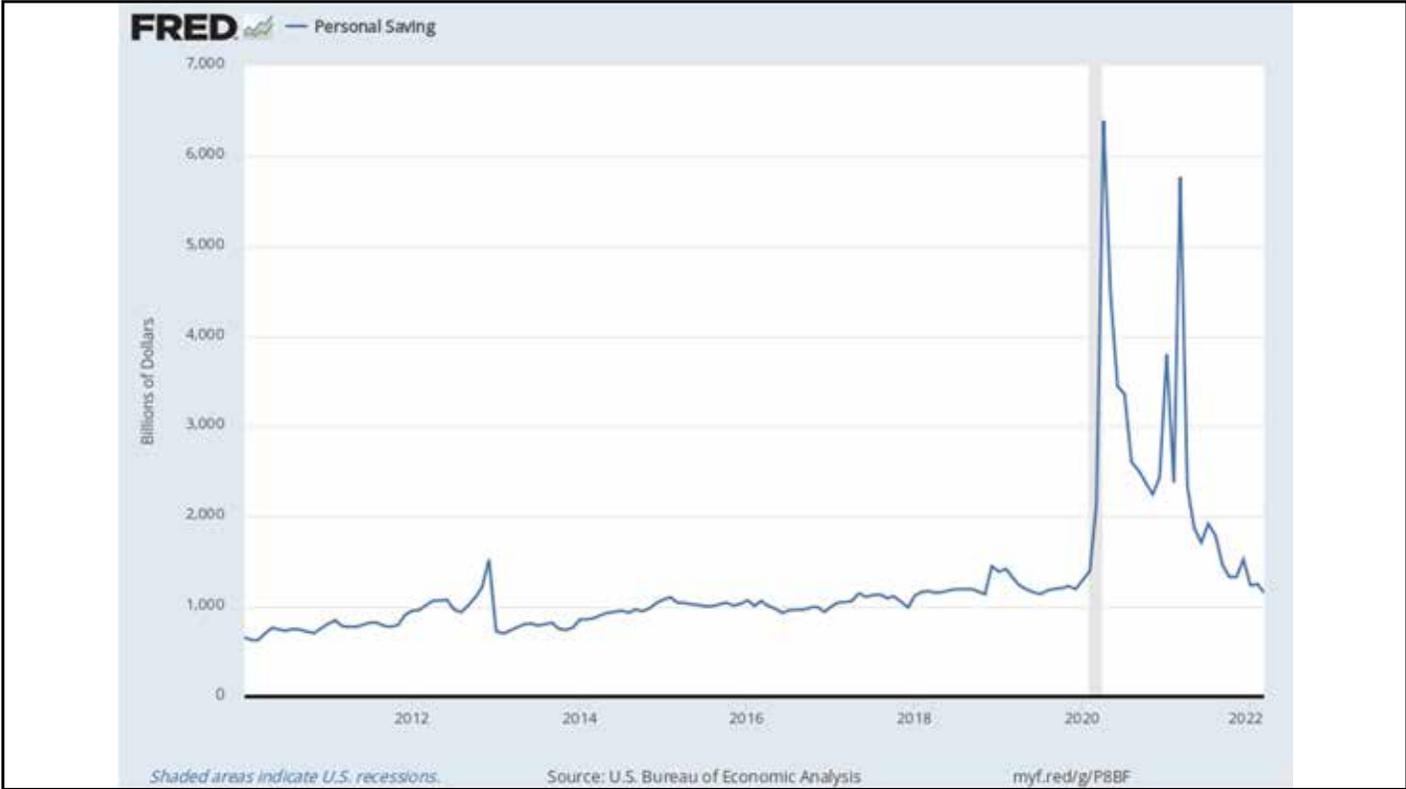
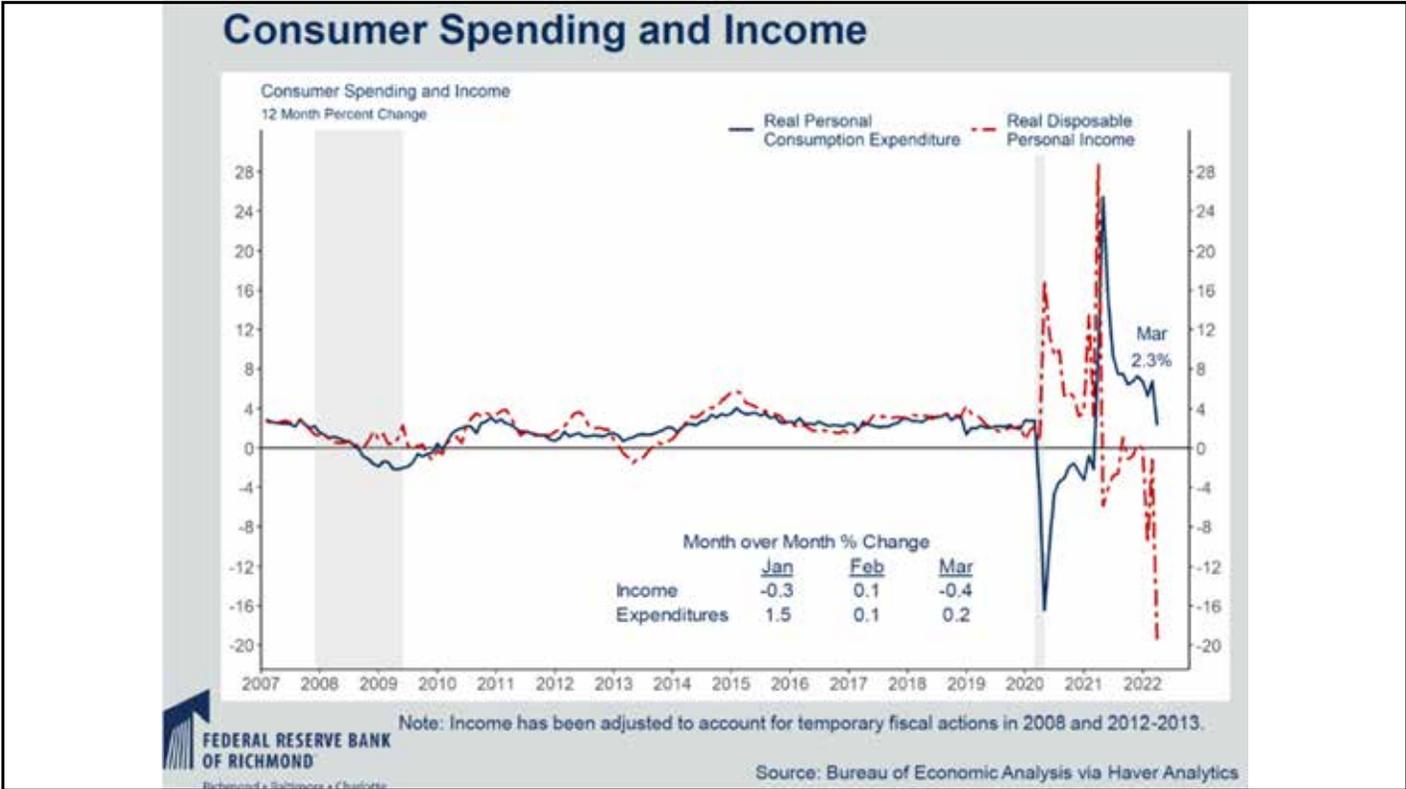
# CONSUMER CREDIT

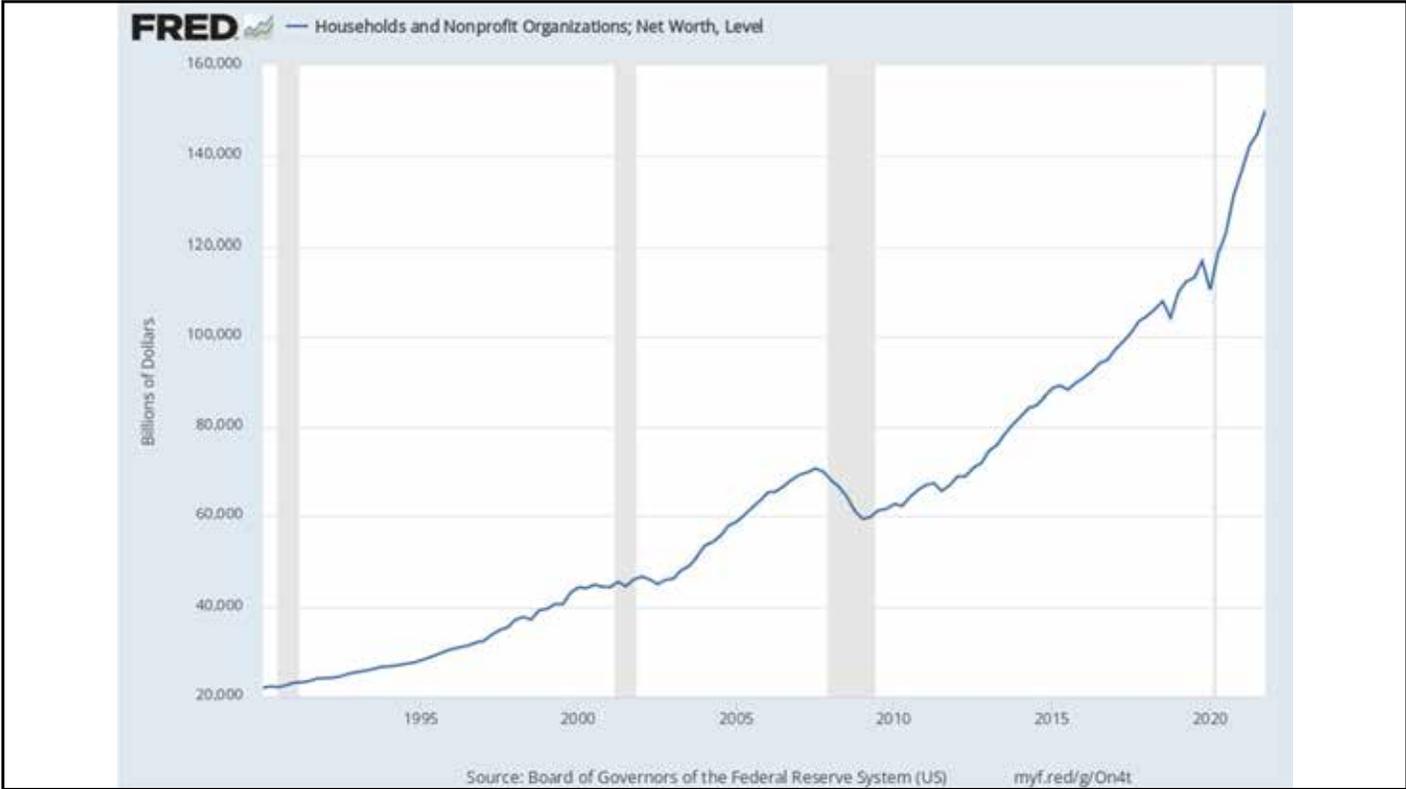


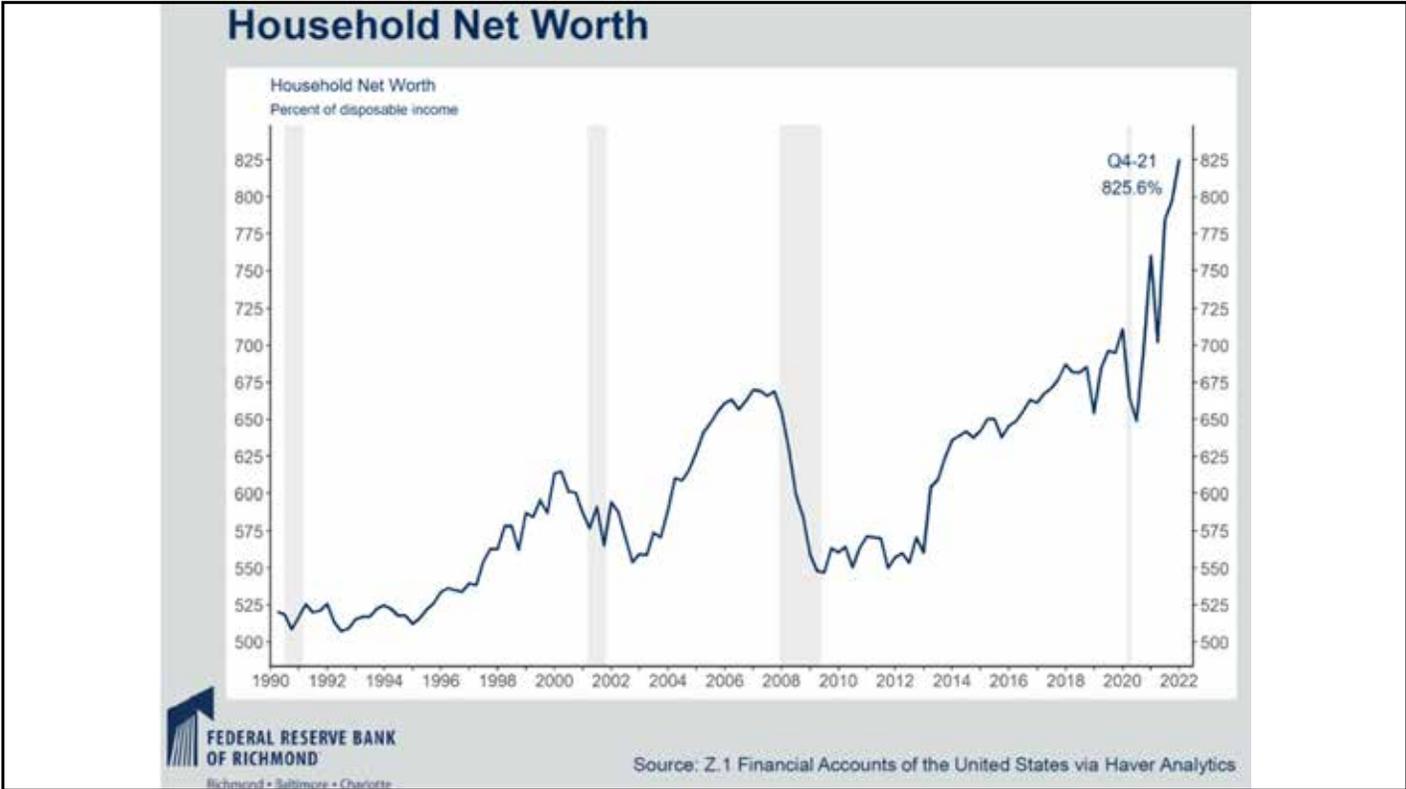




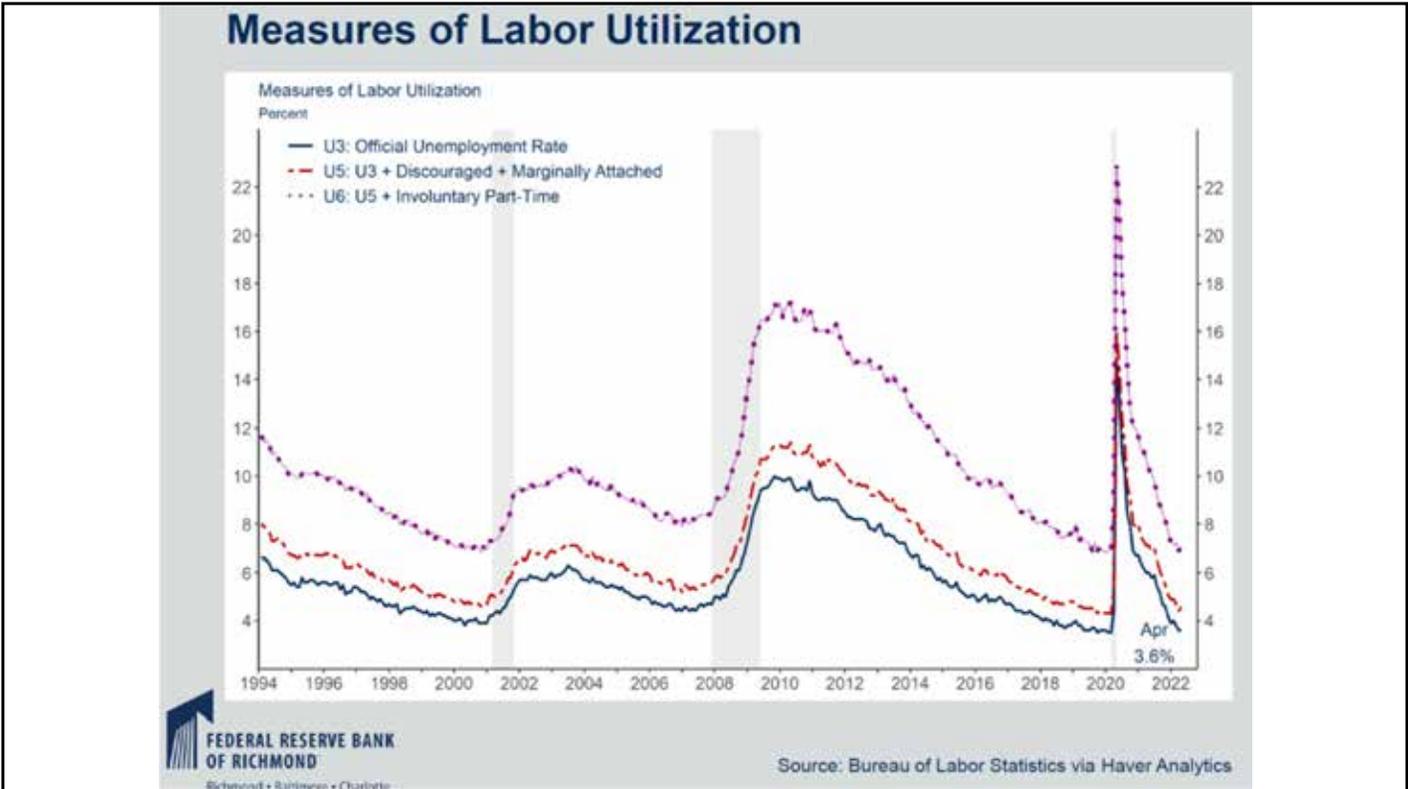
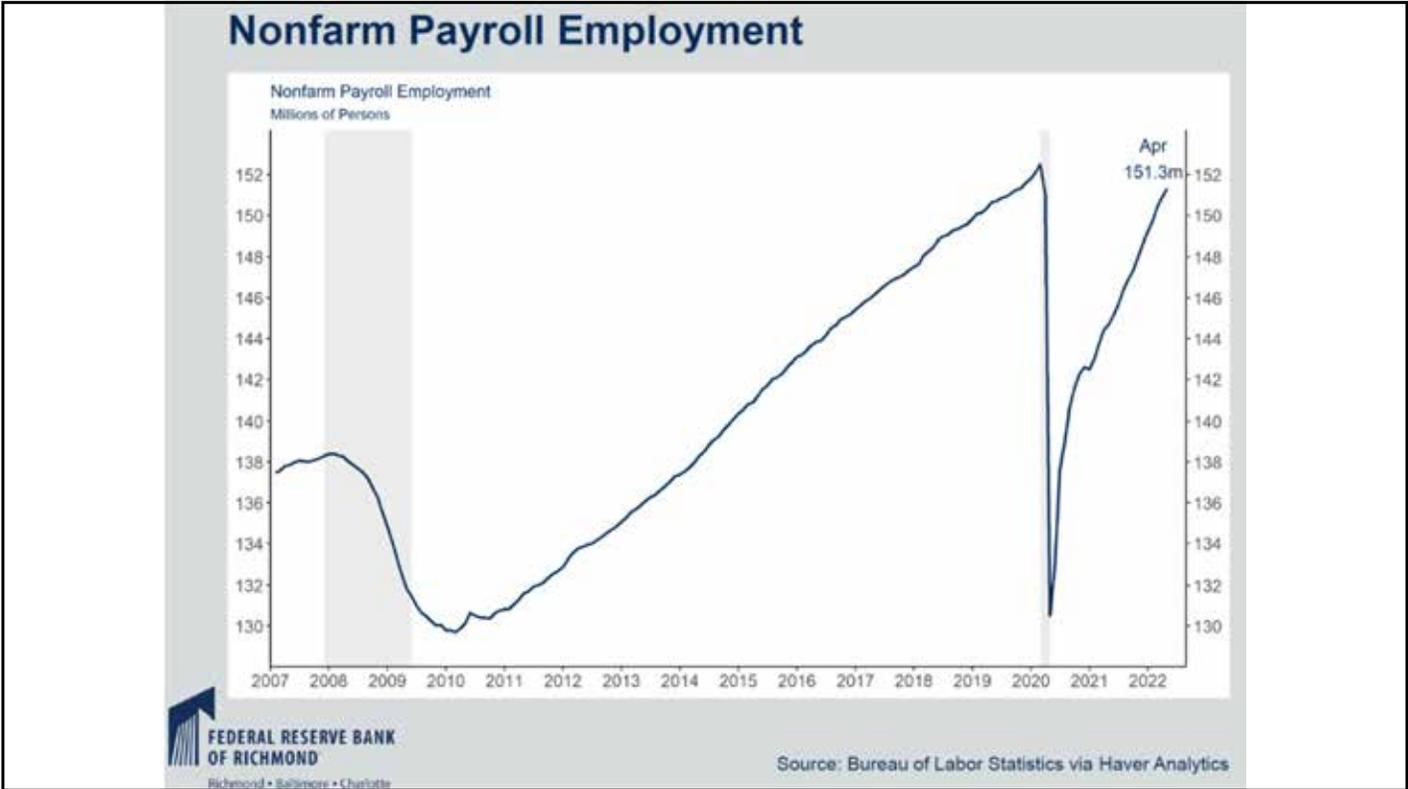
# HOUSEHOLD INCOME SPENDING AND WEALTH

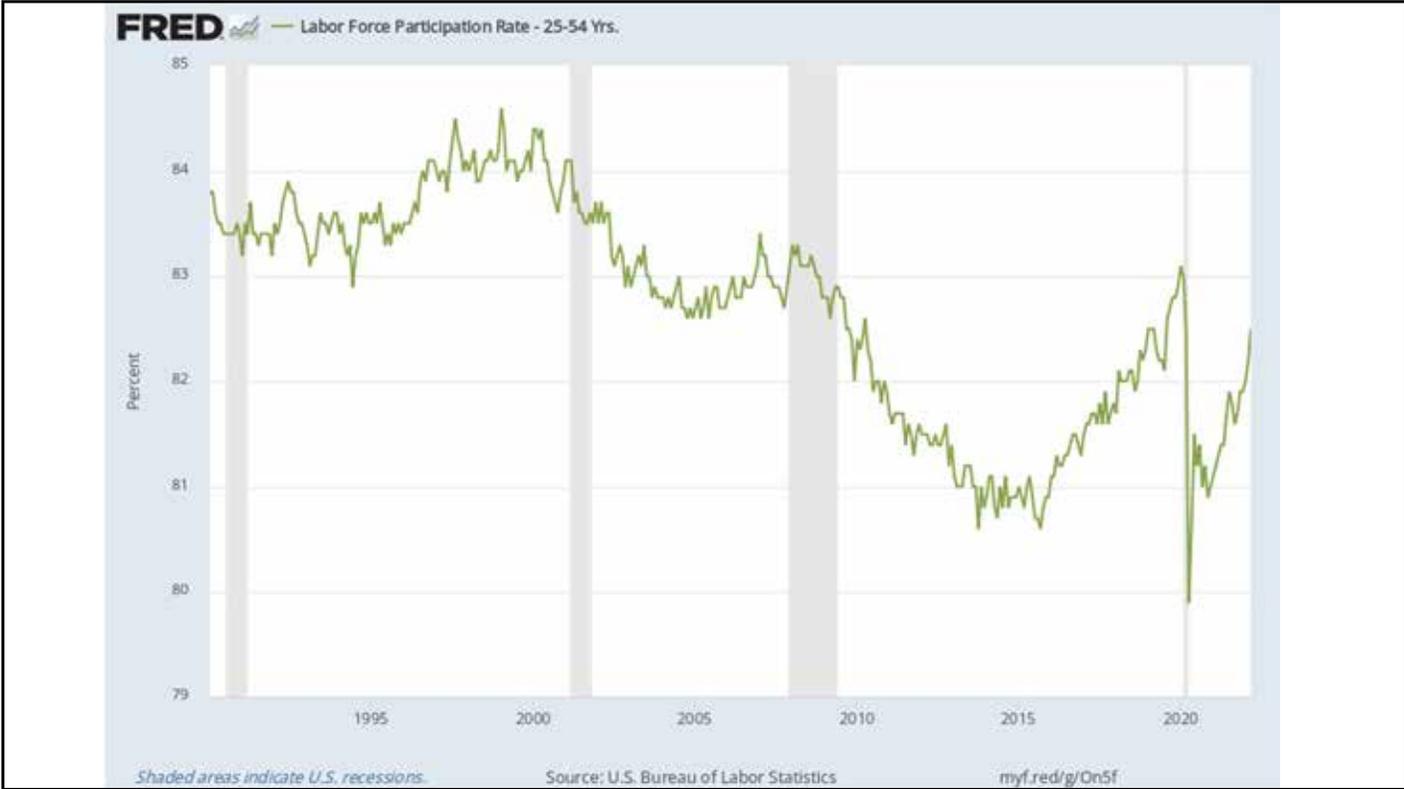
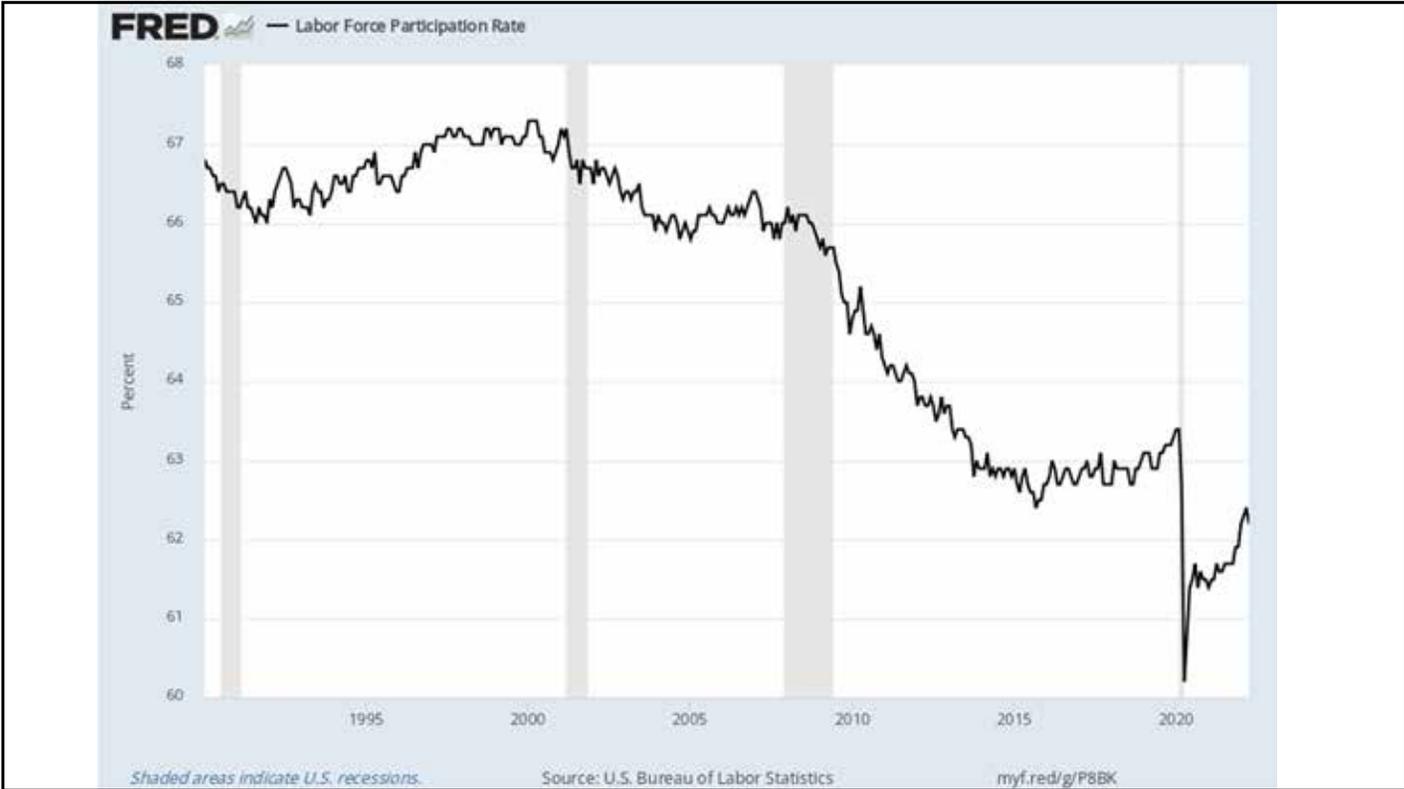


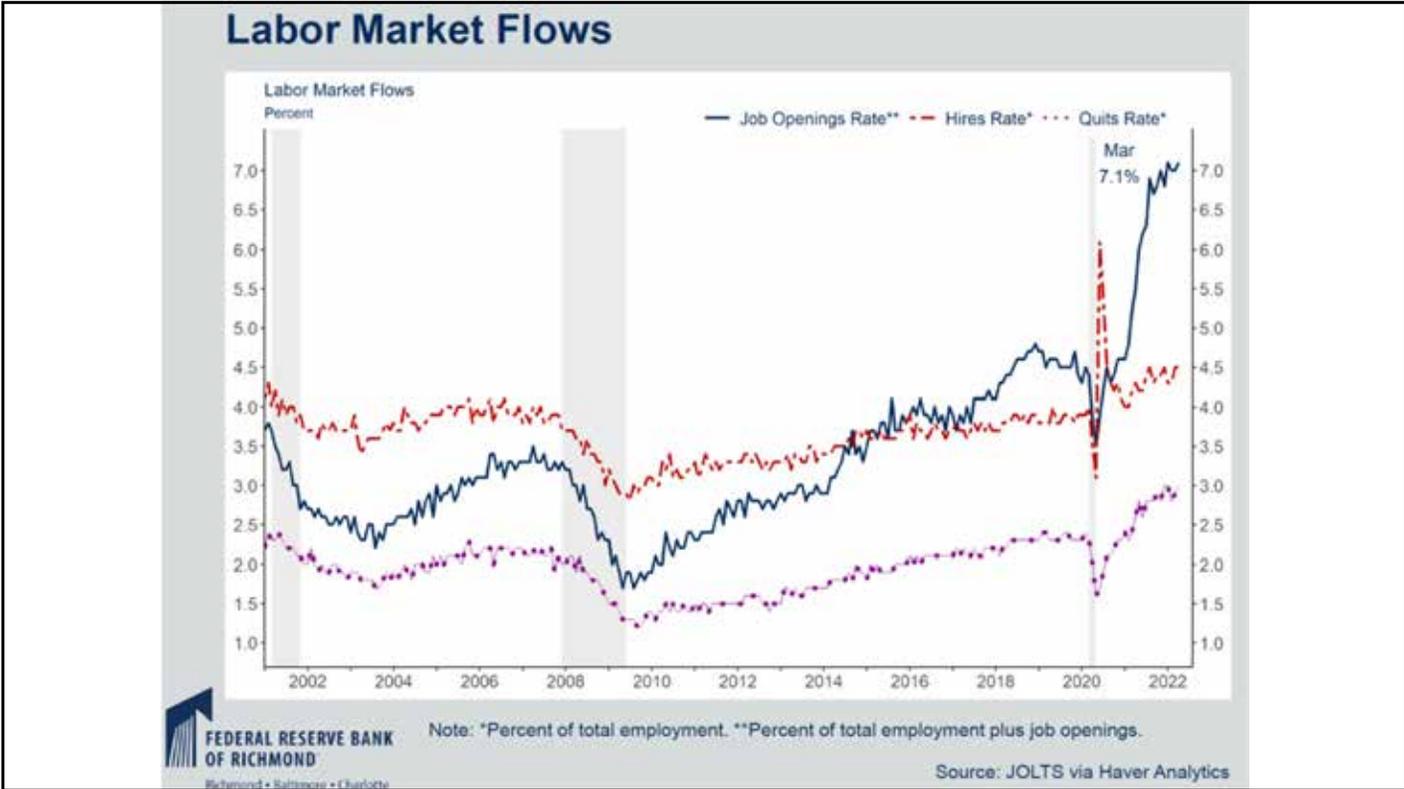




# LABOR MARKETS







# CONSUMER PRICES AND INFLATION

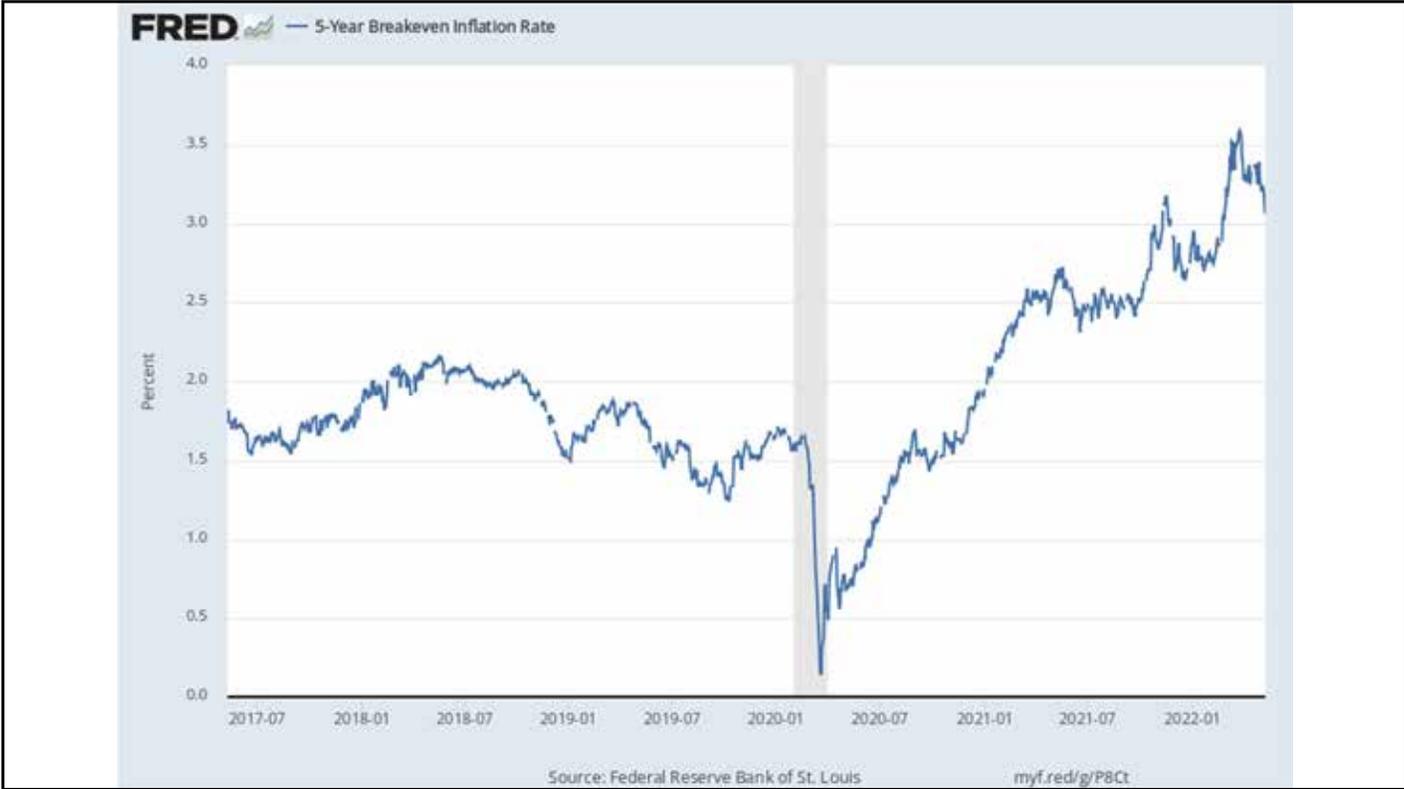
## Gauges of Inflation

<b>Expenditure Price Indexes</b>		[Percent Change from Previous Month at Annual Rate]:		
		<b>Feb.</b>	<b>Mar.</b>	<b>YoY %</b>
Personal Consumption Expenditures		6.4	10.9	6.6
Core (excludes Food and Energy)		3.5	3.6	5.2
<b>Consumer Price Indexes</b>		[Percent Change from Previous Month at Annual Rate]:		
		<b>Feb.</b>	<b>Mar.</b>	<b>YoY %</b>
All Items		10.0	15.9	8.5
Core (excludes Food and Energy)		6.2	4.0	6.5
<b>Producer Price Indexes</b>		[Percent Change from Previous Month at Annual Rate]:		
		<b>Feb.</b>	<b>Mar.</b>	<b>YoY %</b>
Final Demand Goods		11.9	17.8	11.2
Core (excludes Food and Energy)		4.8	12.3	9.2
Core Intermediate Goods		3.3	10.5	18.7
Crude Goods		334.5	-15.2	40.9
<b>Spot Commodity Price Index</b>		[Percent Change from Previous Month]:		
		<b>Mar.</b>	<b>Apr.</b>	<b>YoY %</b>
CRB Spot Commodity Price Index		4.1	1.4	20.9



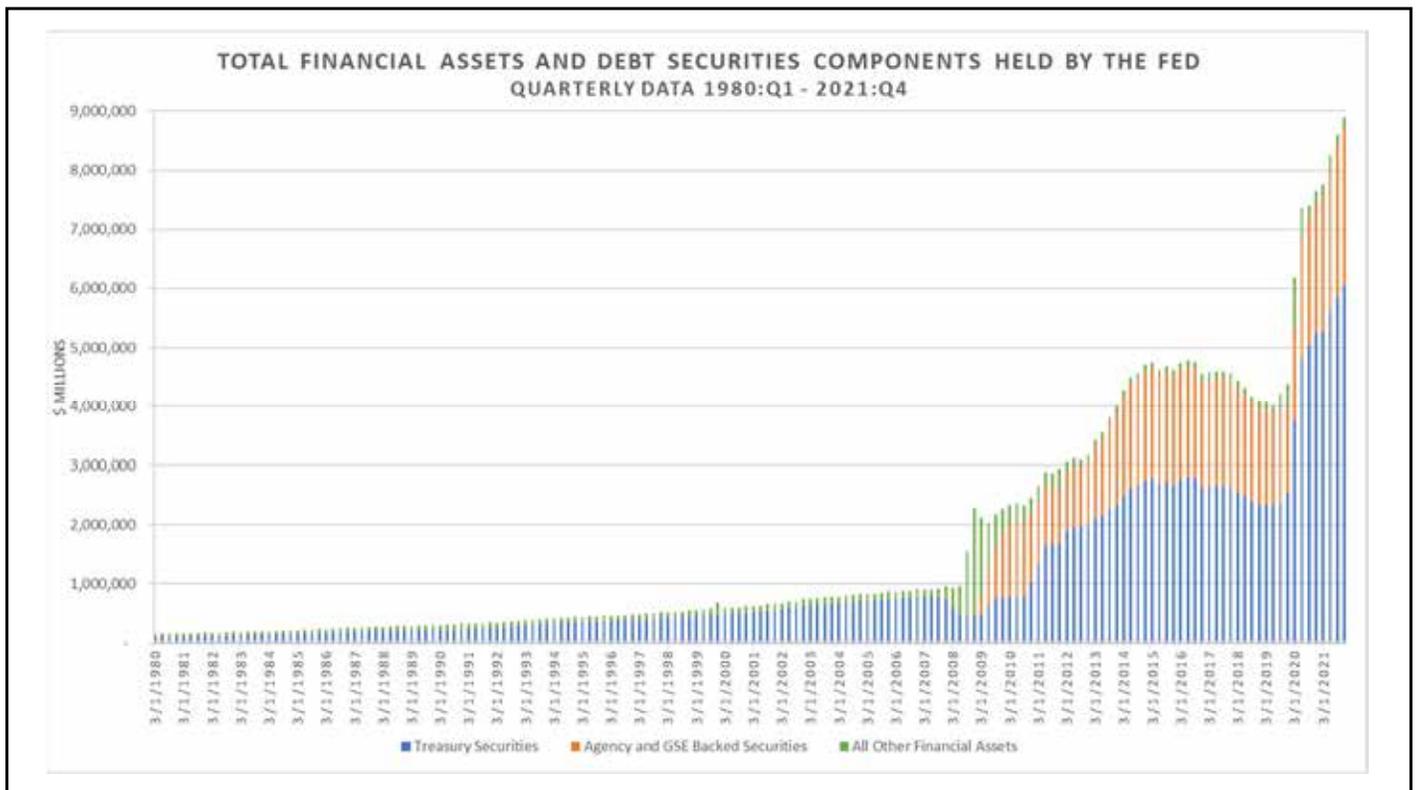
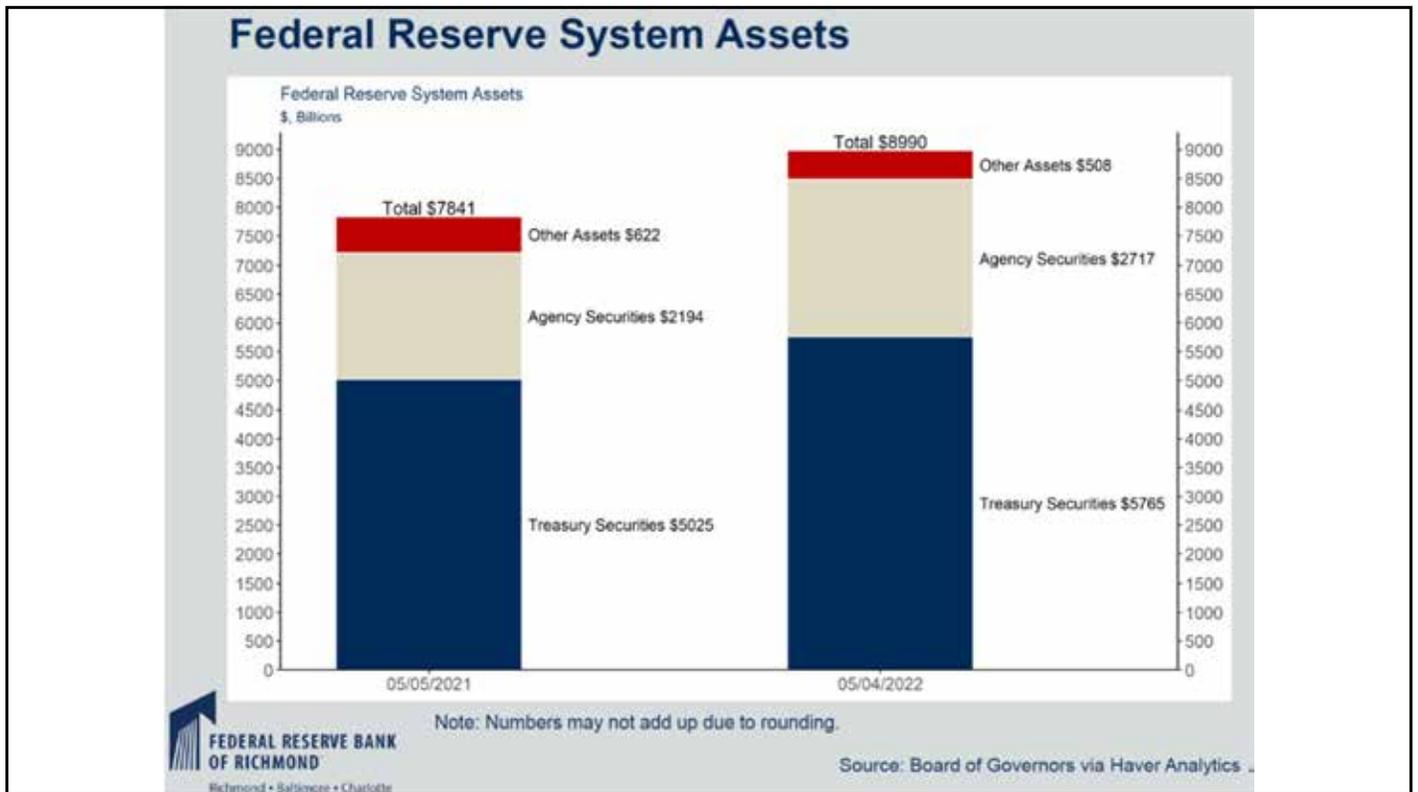
Notes: Core PCE Price Index includes expenditures on food services.

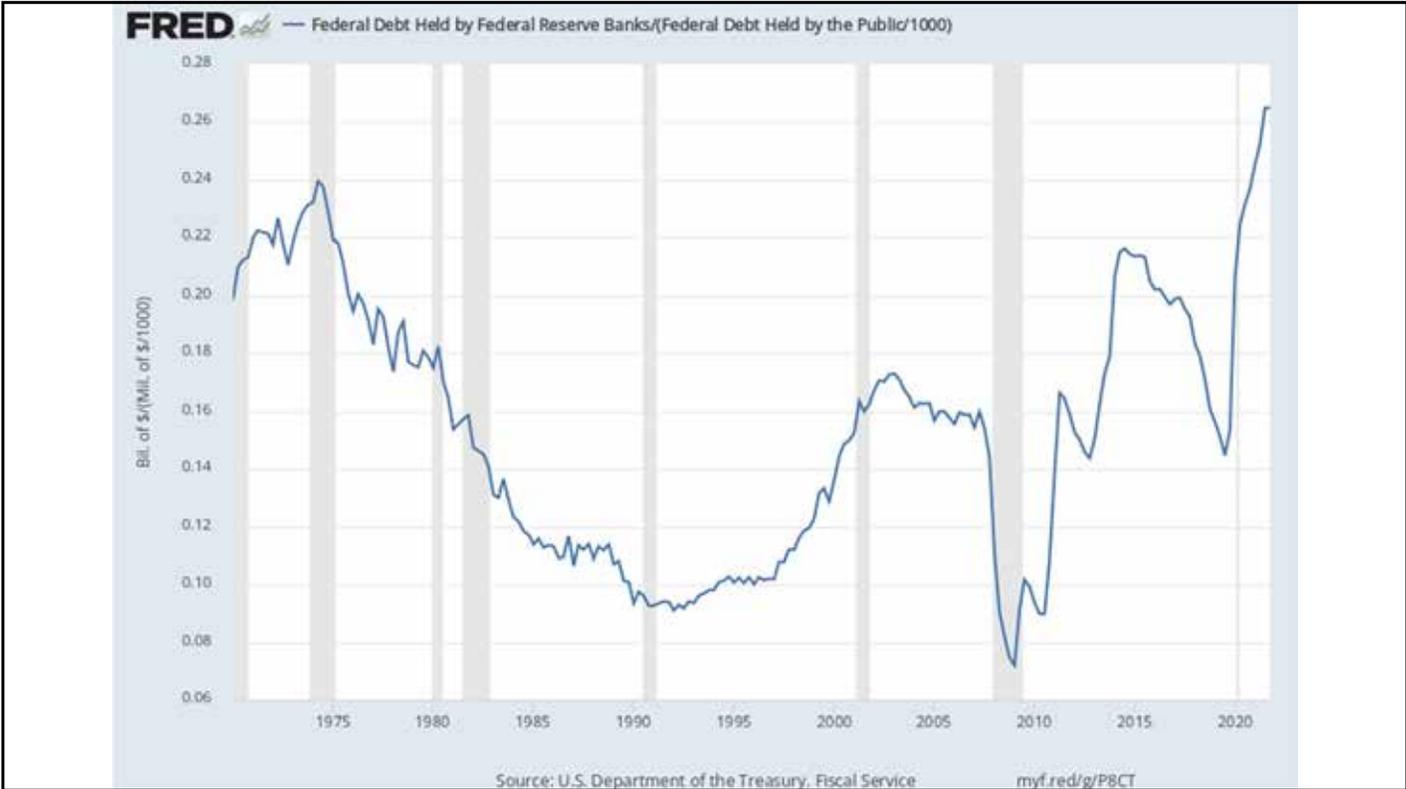
Source: BEA, BLS, & Commodity Research Bureau via Haver Analytics

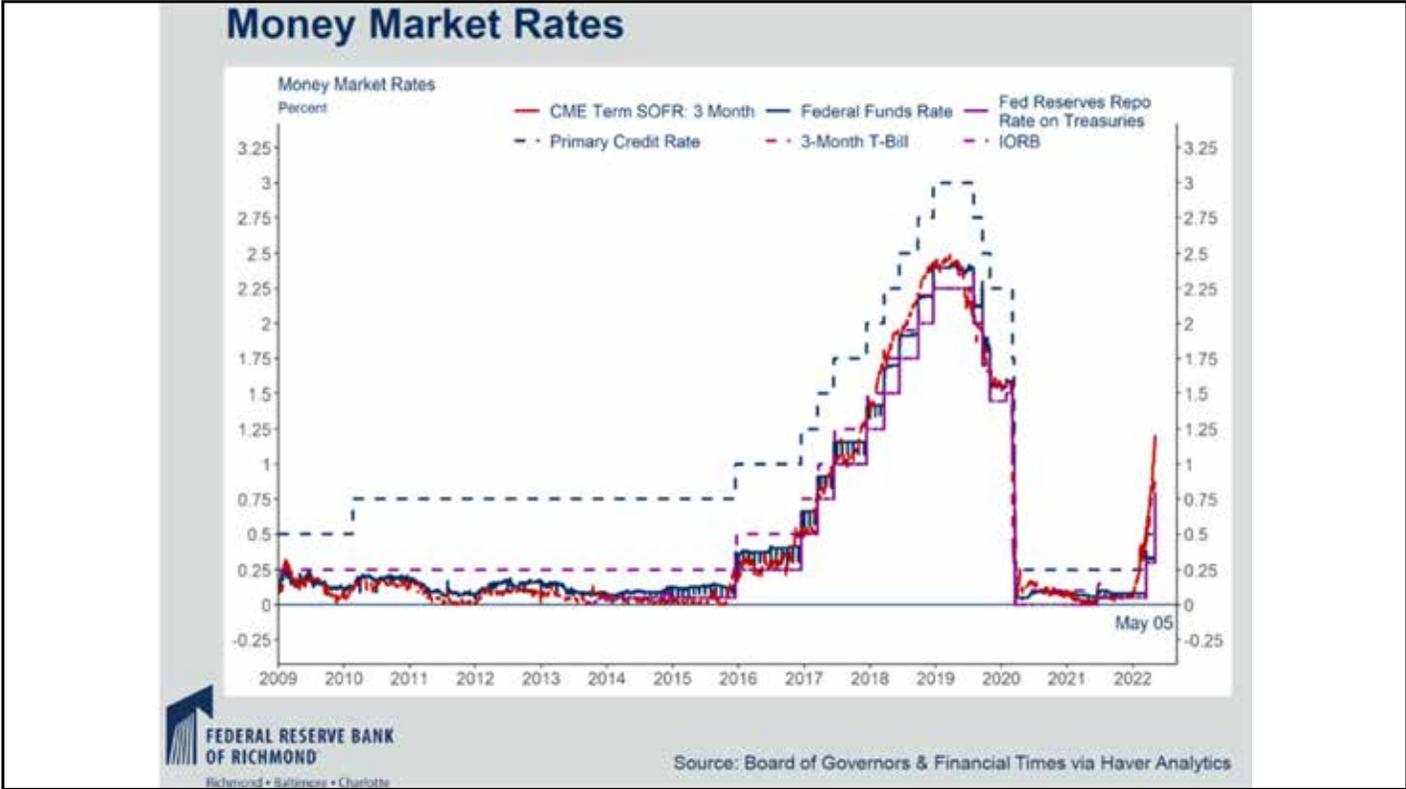




# CAPITAL MARKETS AND THE FED

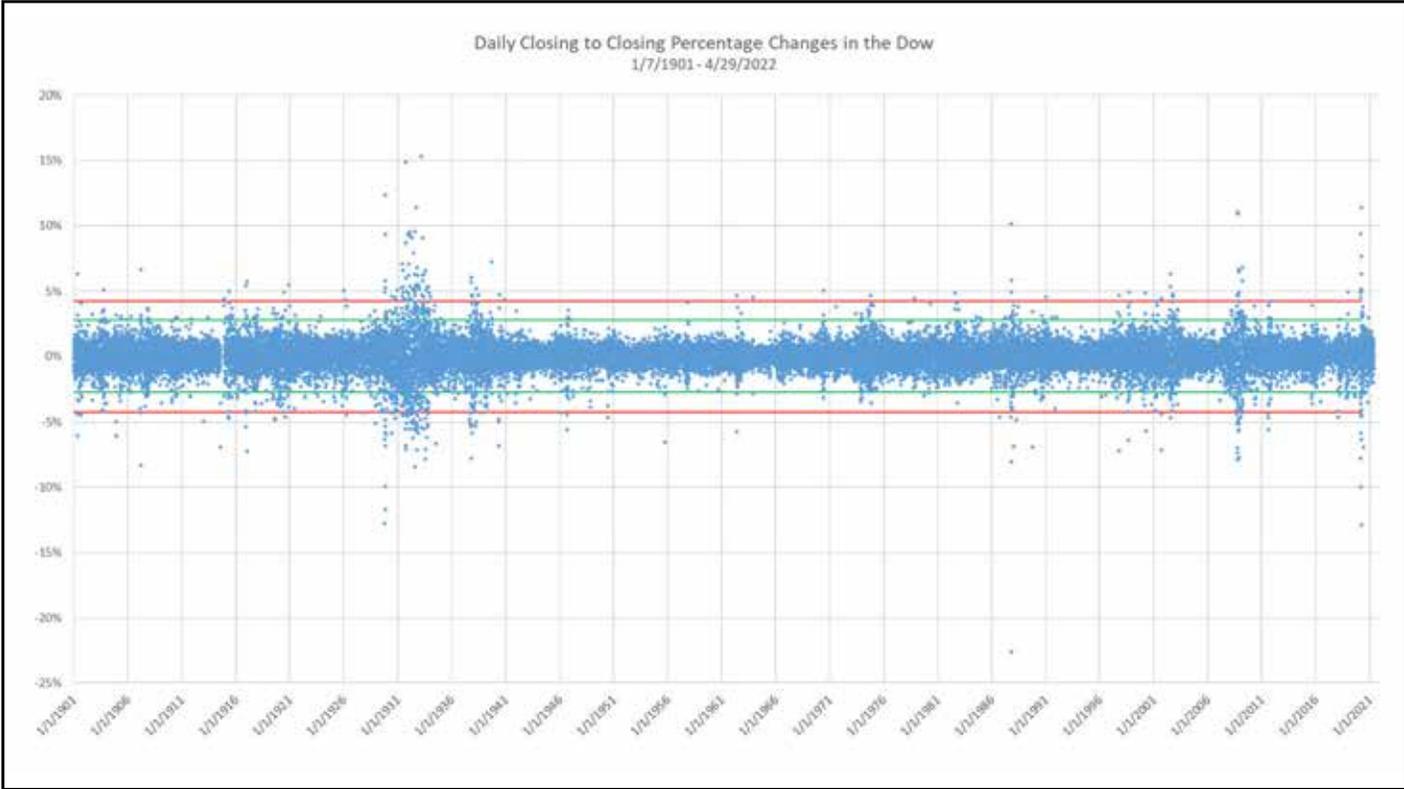
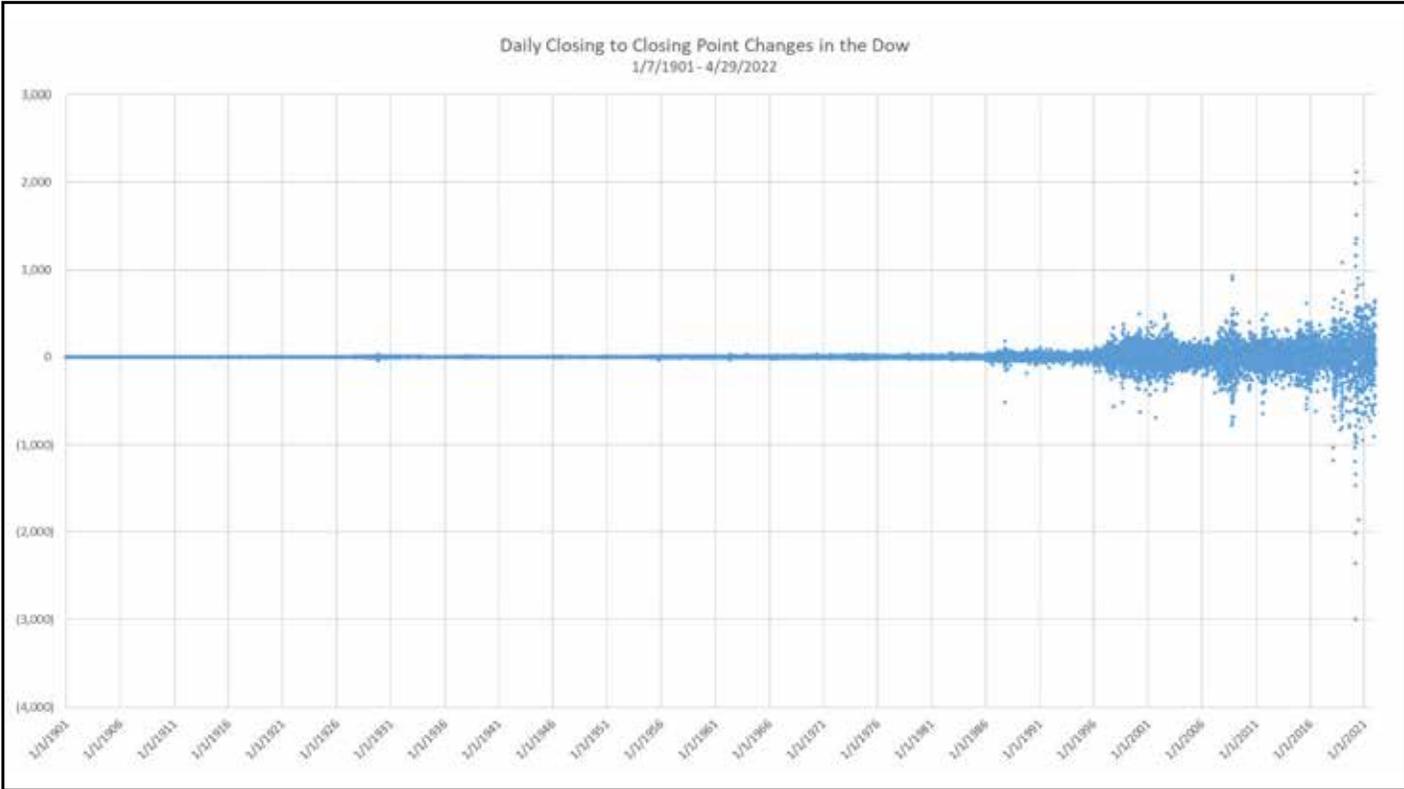












# RETIREMENT SAVINGS AND OLDER AMERICANS

THIS BURRITO COSTS MORE THAN WHAT 45% OF  
AMERICANS HAVE SAVED FOR RETIREMENT



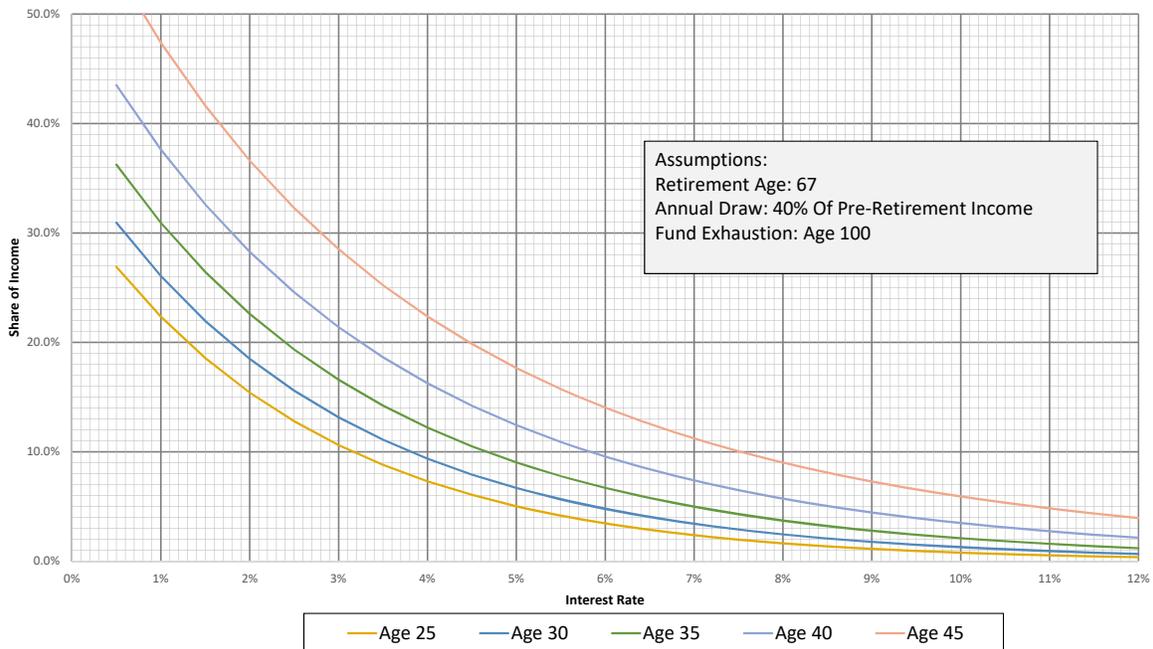
# The Retirement Savings Crisis

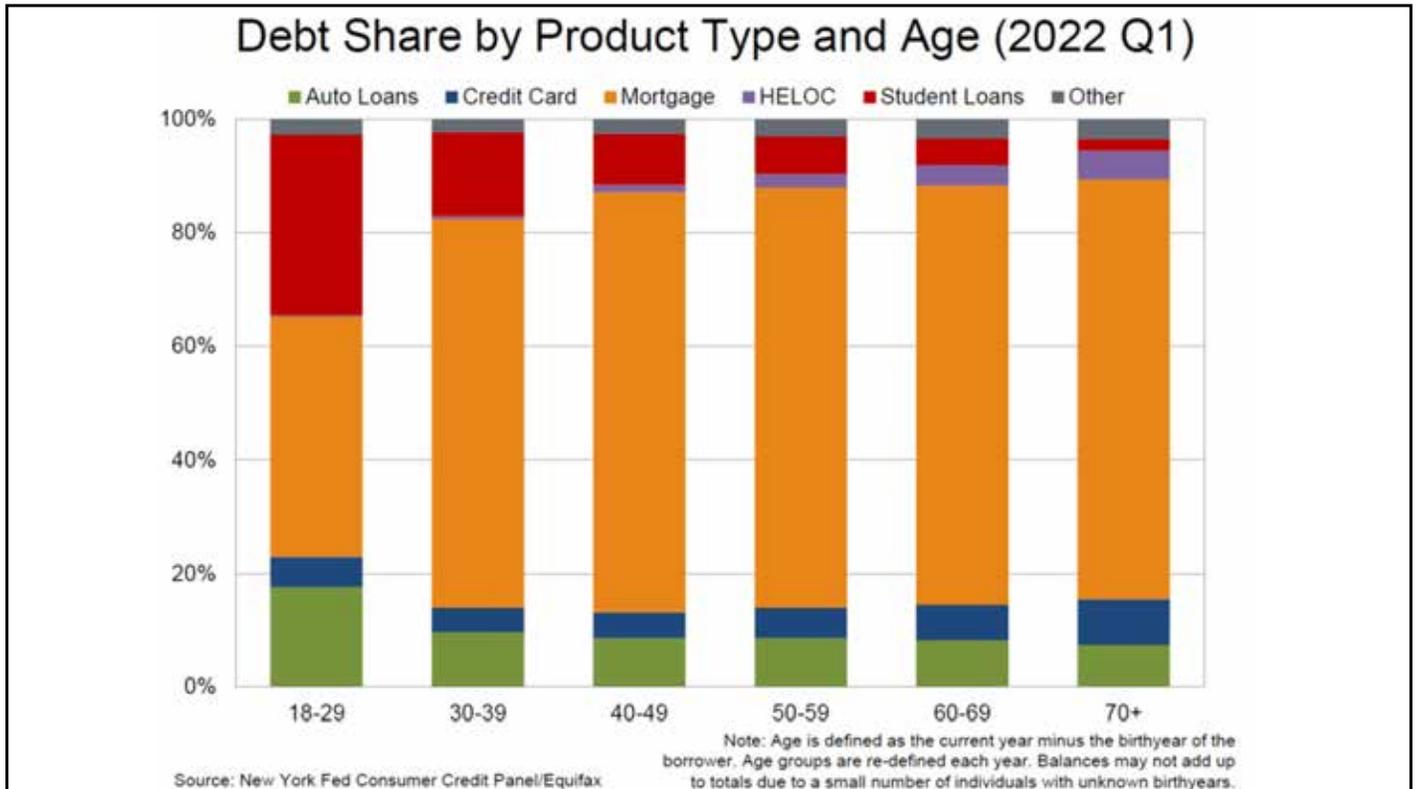
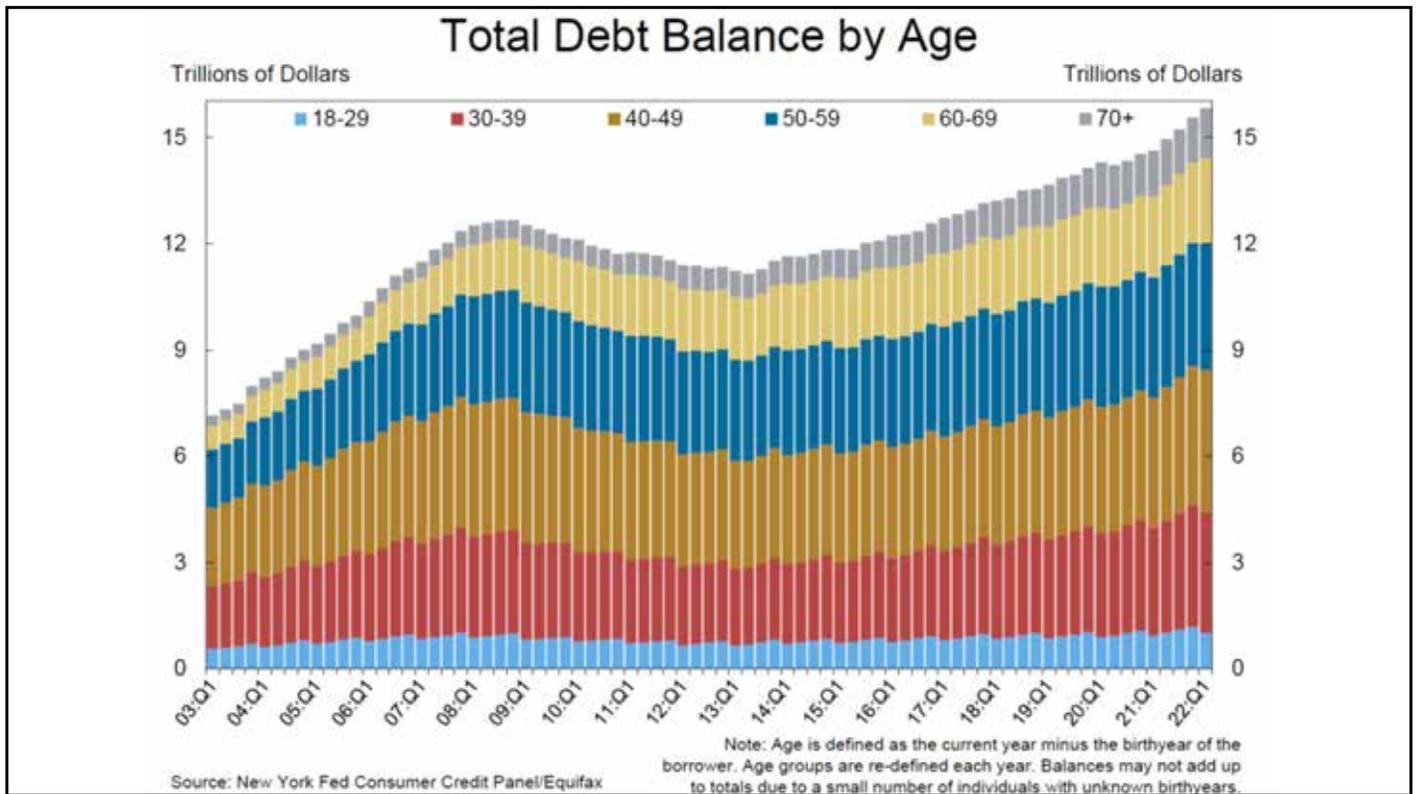
## Retirement Savings by Age Group Dollar Value for Those With Savings (\$000s)

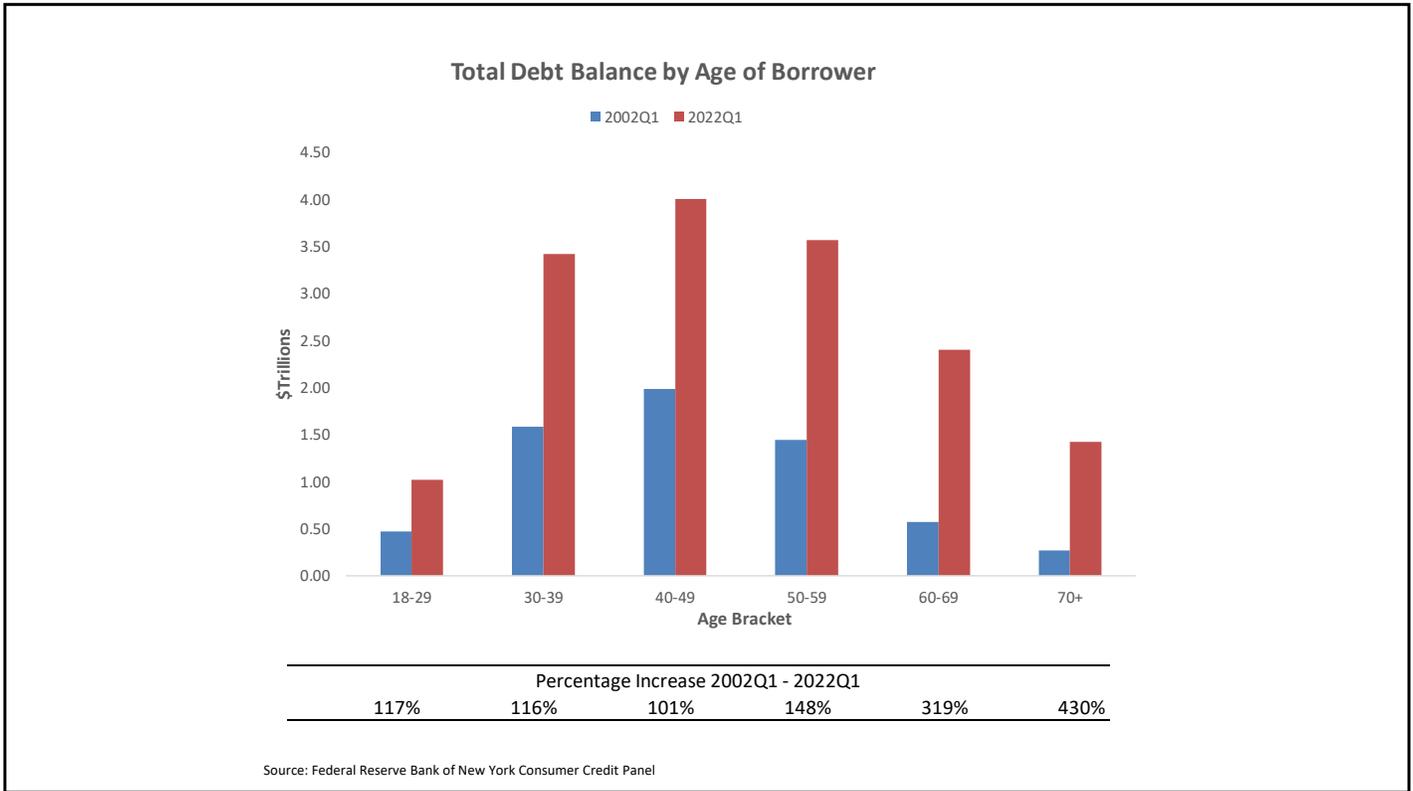
Age	Mean Value Of Holdings	Median Value Of Holdings	% With Zero Savings
Less than 35	30.2	13.0	54.7%
35–44	132.0	60.0	44.2%
45–54	254.7	100.0	42.1%
55–64	408.4	134.0	45.5%
65–74	426.1	164.0	51.9%
75 or more	357.9	83.0	62.3%

2019 Triennial Survey of Consumer Finances  
Board of Governors of the Federal Reserve System

Percentage Of Income That Must Be Saved Under Various Interest Rates  
As A Function Starting Age



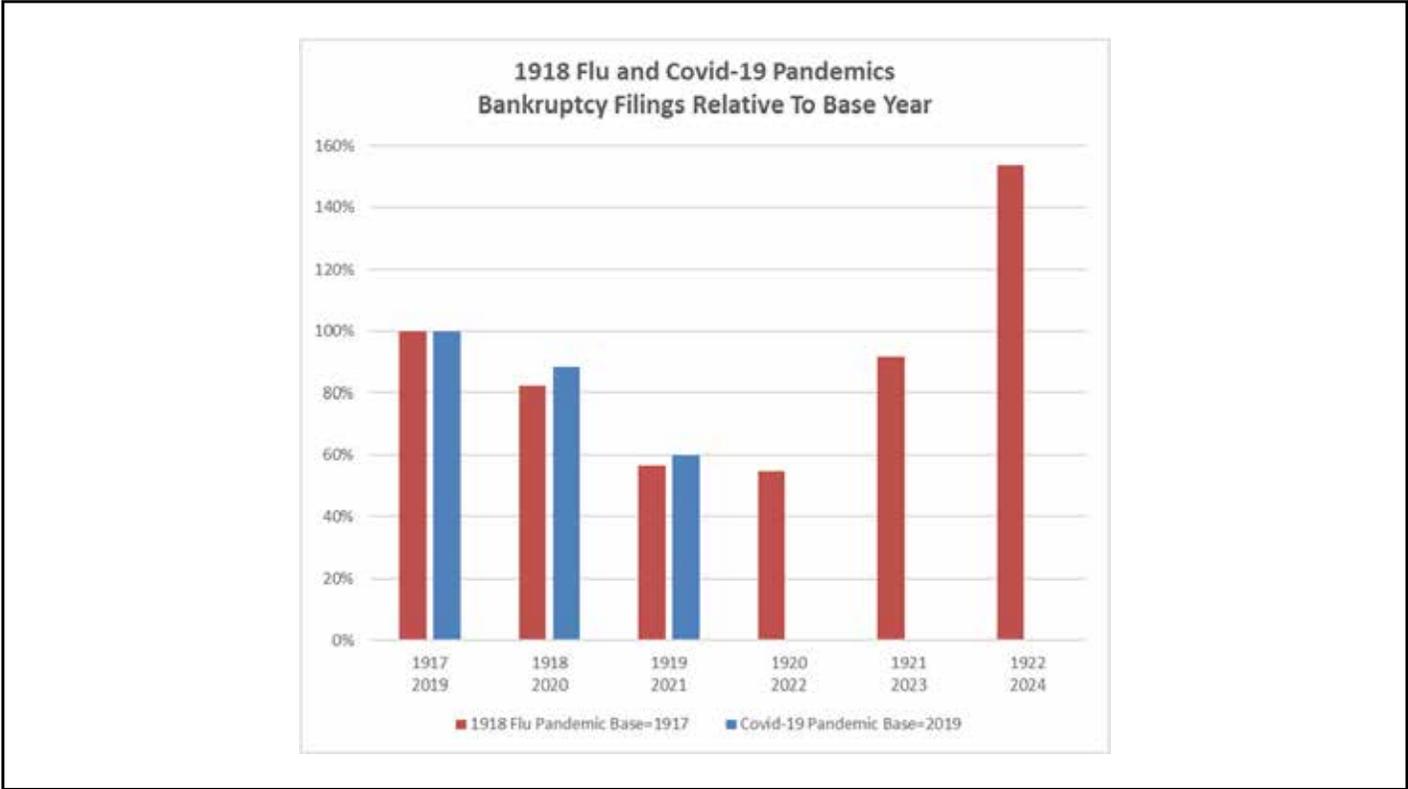




## SHARE OF NEW BANKRUPTCIES BY AGE BRACKET

Year:Quarter	Age Bracket					
	18-29	30-39	40-49	50-59	60-69	70+
2002:Q1	14.5%	28.6%	27.2%	17.9%	7.4%	4.3%
2007:Q1	10.8%	26.2%	28.5%	20.2%	9.6%	4.7%
2012:Q1	6.0%	22.0%	29.6%	24.3%	12.6%	5.5%
2017:Q1	7.1%	20.3%	26.4%	24.1%	14.8%	7.3%
2022:Q1	6.6%	19.1%	24.6%	24.3%	16.2%	9.3%
<b>Increase</b>						
2002:Q1-2022:Q1	-54.4%	-33.4%	-9.8%	35.3%	120.1%	114.6%

Source: Federal Reserve Bank of New York Consumer Credit Panel / Equifax





**Chapter 2A**  
**Washington State Homestead  
Exemption Issues**

**CHRISTINA HENRY**  
Henry & DeGraaff PS  
Seattle, Washington

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# WASHINGTON STATE HOMESTEAD EXEMPTION ISSUES

NWBI 2022  
Christina L Henry  
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## Washington Homestead Exemption Statute

- RCW 6.13.030

Homestead exemption amount.

- (1) The homestead exemption amount is the greater of:
  - (a) \$125,000;
  - (b) The county median sale price of a single-family home in the preceding calendar year; or
  - (c) Where the homestead is subject to execution, attachment, or seizure by or under any legal process whatever to satisfy a judgment in favor of any state for failure to pay that state's income tax on benefits received while a resident of the state of Washington from a pension or other retirement plan, no dollar limit.
- (2) In determining the county median sale price of a single-family home in the preceding year, a court shall use data from the Washington center for real estate research or, if the Washington center no longer provides the data, a successor entity designated by the office of financial management.
- New Statute fixed the language in the prior statute that only protected “equity” in a home up to \$125,000 and “equity” in personal property used as a home of up to \$15,000 based on the “lesser of” the “net value” as determined at a state sheriff's sale
- The homestead statute was amended in 2021 because it was incompatible with the goals and purposes of the state homestead and bankruptcy law

## Washington Homestead Exemption Statute (cont'd)

- RCW 6.13.010
- Homestead, what constitutes—Terms defined.
  - (1) The homestead consists of real or personal property that the owner or a dependent of the owner uses as a residence. In the case of a dwelling house or mobile home, the homestead consists of the dwelling house or the mobile home in which the owner resides or intends to reside, with appurtenant buildings, and the land on which the same are situated and by which the same are surrounded, or improved or unimproved land, regardless of area, owned with the intention of placing a house or mobile home thereon and residing thereon. A mobile home may be exempted under this chapter whether or not it is permanently affixed to the underlying land and whether or not the mobile home is placed upon a lot owned by the mobile home owner or a dependent of the owner. Property included in the homestead must be actually intended or used as the principal home for the owner.
  - (2) As used in this chapter:
    - (a) "Owner" includes but is not limited to a purchaser under a deed of trust, mortgage, or real estate contract.
    - (b) "Net value" means market value less all liens and encumbrances senior to the judgment being executed upon and not including the judgment being executed upon.
    - (c) "Forced sale" includes any sale of homestead property in a bankruptcy proceeding under Title 11 of the United States Code. The reinvestment provisions of RCW 6.13.070 do not apply to the proceeds.
    - (d) "Dependent" has the meaning given in Title 11 U.S.C. Sec. 522(a)(1).

New Statute codified *In re Good*, 588 B.R. 573 (Bankr. W.D. Wash. 2018) and included the definition from 11 U.S.C. Sec. 522(a)(1) that included dependents.

## Washington Homestead Exemption Statute (cont'd)

- RCW 6.13.070
- Homestead exempt from execution, when—Presumed valid.
  - (1) Except as provided in RCW 6.13.080, the homestead is exempt from attachment and from execution or forced sale for the debts of the owner up to the amount specified in RCW 6.13.030.
  - (2) **In a bankruptcy case**, the debtor's exemption shall be determined on the date the bankruptcy petition is filed. If the **value** of the debtor's interest in homestead property on the petition date is less than or equal to the amount that can be exempted under RCW 6.13.030, then the debtor's entire interest in the property, including the debtor's right to possession and interests of no monetary value, is exempt. Any appreciation in the value of the debtor's exempt interest in the property during the bankruptcy case is also exempt, even if in excess of the amounts in RCW 6.13.030(1).
  - (3) The **proceeds** of the voluntary sale of the homestead in good faith for the purpose of acquiring a new homestead, and proceeds from insurance covering destruction of homestead property held for use in restoring or replacing the homestead property, up to the amount specified in RCW 6.13.030, shall likewise be exempt for one year from receipt, and also such new homestead acquired with such proceeds.
  - (4) Every homestead created under this chapter is presumed to be valid to the extent of all the property claimed exempt, until the validity thereof is contested in a court of general jurisdiction in the county or district in which the homestead is situated.

New Statute included bankruptcy only provisions specifically to modernize the law and to address the case of *Wilson v. Rigby*, 909 F.3d 306 (2018).

## The Allowance of Exemptions

- A debtor may use either state or federal exemptions.
  - States have virtually unbridled authority to determine what exemptions are available and to establish their metes and bounds. See *Sticka v. Applebaum (In re Applebaum)*, 422 B.R. 684, 689 (B.A.P. 9th Cir. 2009).
  - The Code also allows States to *opt out* of the default federal scheme, making only the state-law exemptions available to debtors (subject to several narrow exceptions). 11 U.S.C. 522(b)(1).
    - Additionally, “a separate bankruptcy-only exemption schedule is not in and of itself pre-empted by the Supremacy Clause.” *Applebaum*, 422 B.R. at 690.

## The Current State of Ninth Circuit Caselaw re State Homestead Statutes

*Klein v. Chappell (In re Chappell)*, 373 B.R. 73, 81 (B.A.P. 9th Cir. 2007)

In *Chappell* :

- Bankruptcy estate retains an interest in the debtor's home where the value of the debtor's homestead exemption equals or exceeds the equity in the home.
- Debtor's interest in the home was limited to the dollar value exemption claimed.
- Bankruptcy estate retains an interest in the debtor's home such that post-petition appreciation inures to the bankruptcy estate.

## The Current State of Ninth Circuit Caselaw re State Homestead Statutes (cont'd)

*Gebhart v. Gaughan (In re Gebhart)*, 621 F.3d 1206, 1210 (9th Cir. 2010)

- The dollar amount of the Debtor's claimed exemption is frozen as of the petition date.
- The estate is entitled to post-petition appreciation in the exempt asset until the bankruptcy case is closed or the estate abandons the property.



## The Current State of Ninth Circuit Caselaw re State Homestead Statutes (cont'd)

*Wilson v Rigby*, 909 F.3d 306 (9<sup>th</sup> Cir. 2018)

1. Appreciation inures to the bankruptcy estate via 11 USC 541(a)(6)
2. The exemption is fixed as of the date of filing.
3. In CA, that exemption amount was a fixed amount, i.e. \$ 45k
4. In Wa before the statute change, it was the lesser of the net value, or 125k

## *Wilson v Rigby* contrasting with *In re Alsberg*

- The Washington Homestead provides for the lesser of (net equity) as of petition date or \$125k;
- At the time, California's Homestead provided for a fixed amount at \$45k in *Alsberg*.



## Consumer Bankruptcy Cases in WA state After *Wilson v Rigby* and Before the Homestead Amendment

1. Consumer debtors risked losing their homes if they filed chapter 7 even when the equity was less than \$125k at the time of filing because of the appreciating market
2. Chapter 7 Trustees kept many cases open for years to capture the appreciation
3. Courts often denied motions to abandon without first allowing a real estate agent to put the home on the market
4. Result – many debtors in WA looked to other means to deal with debt matters as bankruptcy was not a feasible option. Chapter 13 cases increasingly required 100% payment plans and/or included sales of the home to satisfy the liquidation value required by the plan. As prices rise, equity scams in the marketplace also increase as debtors look for ways to keep their homes and satisfy their creditors outside of bankruptcy.

## Exemptions – 11 U.S.C. 522

- A homestead exemption maintains the status it has on the day a bankruptcy is filed
  - *Owen v. Owen*, 500 U.S. 305, 308 (1991)
    - The effect of an exemption is that when an interest in property is valued below the exemption limit at the time of the bankruptcy filing the debtor's interest in the property is withdrawn from the estate (and hence from the creditors) for the benefit of the debtor.
  - *Schwab v Reilly*, 560 US 770
    - When an exemption in an interesting property is valued above the exemption limit, the debtor's interest in the property is limited to the dollar amount exempted and the property remains in the bankruptcy estate until administered or abandoned.
      - Noting 100% of FMV or full FMV may exempt an entire asset as opposed to just the dollar value interest.
  - *Law v. Siegel*, 134 S. Ct. 1188, 1197 (2014).
    - Federal law provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code.

## Issues regarding Post-Petition Appreciation(cont'd)

- Does the language of the state statute indicate that equity belongs to the Debtor or the Bankruptcy Estate?
- Is there an objection to the Exemption? If not, the exemption is assumed valid.
- Was the exemption taken in “equity” as opposed to an exemption in the whole property?
  - See *In re Ayobami*, 15-35488, 2016 WL 3854052, at \*9 (Bankr. S.D. Tex. June 9, 2016), certified question answered sub nom. *In matter of Ayobami*, 879 F.3d 152 (5th Cir. 2018).

## Issues regarding Post-Petition Appreciation (cont'd)

- Is a homestead exemption protected in conversion under 11 USC 348?
  - *In re Castleman*, 631 B.R. 914, 917 (Bankr. W.D. Wash. 2021) – Interpreting 11 USC 348(f)(1)(A), a Washington State bankruptcy court followed the minority view to find that post petition appreciation should not be treated separately from pre-petition property and inures to the bankruptcy estate, not the debtor. Thus, upon conversion from Chapter 13 to Chapter 7, any post petition appreciation can be captured by the bankruptcy estate. See *In re Reed*, 940 F.2d 1317 (9<sup>th</sup> Cir. 1991).
    - Court made distinction between “value” and “valuation” and found that valuations made prior to conversion were not binding on the Chapter 7 Trustee.
    - Cf. *In re Cofer*, 625 B.R. 194 (Bankr. D. Idaho 2021).

## Problems with Washington’s Homestead Act in Bankruptcy Court

- All assets of the Debtor become Property of the Bankruptcy Estate upon the filing of a petition – 11 USC 541(a) .
- Omnibus Objections to Homestead Exemptions
  - Prevents property from vesting in the debtor when exemptions are filed
- The 9<sup>th</sup> Circuit holds that Post-petition Appreciation in Ch 7’s under 11 USC 541(a)(6) inures to the estate
  - “[p]roceeds, product, offspring, rents, or profits of or from the property of the estate...”
  - This holding may be in conflict with recent US Supreme Court Decisions

## The Snapshot Rule and Chapter 7

### • The Partial Snapshot Rule

- 11 U.S.C. § 522(a)(3) Noting the well-settled holding in this circuit "that what is frozen as of the date of filing the petition is the value of the debtor's exemption, not the fair market value of the property claimed as exempt." *Gebhart v. Gaughan (In re Gebhart)*, 621 F.3d 1206, 1211 (9th Cir. 2010).
- Under *In re Jacobson*, 676 F.3d 1193, 1199 (9th Cir. 2012), the Ninth Circuit has embraced a "partial" snapshot rule, finding that the entire homestead act of a state, including the "reinvestment" provisions after a sale allow a debtor to *lose* the exempt status of an exemption postpetition if homestead assets are not reinvested under the applicable provision of the state exemption scheme.
  - *Gebhardt* and *Wilson v Rigby* are an exception to the general rule that exempt property reverts in the debtor.
- *In re Anderson*, 988 F.3d 1210 (9<sup>th</sup> Cir. 2021)
  - Distinguished *In re Jacobson* and limited *In re Golden*, 789 F.2d 698 (9<sup>th</sup> Cir. 1986) to its facts.
  - Found that Supreme Court precedent not clearly irreconcilable.
- *In re Guevarra*, BAP No. EC-21-1141-SFL (9<sup>th</sup> Cir. B.A.P. March 25, 2022).
  - Debtor may amend schedule to claim exemption in sale proceeds after interest sold by the Bankruptcy Trustee

## The Snapshot Rule and Chapter 7

### • The Complete Snapshot Rule (1<sup>st</sup> Circuit)

- The First Circuit *in Rockwell*, relying on *White v. Stump*, 266 U.S. 310, 313 (1924), found that exemptions are fixed as of the bankruptcy petition date in what is known as the "snapshot rule." *In re Rockwell*, 968 F.3d 12, 21 (1st Cir. 2020), *cert. denied sub nom. Hull v. Rockwell*, No. 20-499, 2021 WL 666390 (U.S. Feb. 22, 2021).
- The *Rockwell* court recognized that the snapshot rule may be either "complete"—meaning that a debtor's exemptions are fixed at the time he files his petition notwithstanding changing circumstances post-petition—or "partial"—meaning that later events may change the status of property claimed as exempt.
  - The court found that a "partial" snapshot is only found where under 11 USC 522(c).
- The Complete Snapshot applies to a debtor's homestead exemption – rendering it unchanged by post-petition circumstances.
- The Bankruptcy Policy of a "fresh start" supports the complete snapshot rule.

## The Snapshot Rule and Chapter 13

- *In re Wells*, No. 20-35984, 2021 WL 5755086, at \*1 (9th Cir. Dec. 3, 2021)
  - Holding – Debtor with homestead exemption who sells homestead while the bankruptcy is pending must reinvest sale proceeds in New Homestead. Case holding adopted holding in *In re Jacobson*, 676 F.3d 1193 (9th Cir. 2012) but found debtors only have a “contingent” homestead exemption, i.e. *fewer rights than debtors in other jurisdictions*.
  - Issue – Is the issue different in Chapter 13 as opposed to Chapter 7?
  - This case will be the subject of a U.S. Supreme Court Petition for Certiorari.

## Recent US Supreme Court Cases Question 9th Circuit Partial Snapshot Rule

- *Law v Siegel*, 571 U.S. 415 (2014)
  - Under *Law v Siegel*, the US Supreme Court held that a Debtor should not be deprived of her exemptions and cannot be considered conditional and subject to postpetition divestiture.
  - Federal law provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code.
- *Harris v. Viegelahn*, 135 S. Ct. 1829 (2015)
  - A Chapter 7 estate allows a debtor to make a “fresh start” by not including the debtor’s “postpetition earnings and acquisitions.” *Harris*, 135 S. Ct. at 1835.
  - The debtor is allowed a “clean break from his financial past,” rendering his transactions off-limits “after the bankruptcy filing.” *Ibid.* (citing 11 U.S.C. 541(a)).
- If a homestead is exempt on that date, then Chapter 7 debtors have the right to use any exempt property for their fresh start—just as they are entitled to retain future wages or profits from any other postpetition transactions. *Harris v. Viegelahn*, 135 S. Ct. 1829 (2015)

## Challenges to Washington’s New Homestead Bill

- *In re Tangonan*, Case No. 21-11288
  - Chapter 7 Trustee brought an objection to homestead exemption
  - Court ruled that entire homestead passes out of the estate under the “non-monetary” language of the statute
- *Wood v Wolf*, Adv Case No. 21-11757
  - Chapter 7 Trustee brought adversary proceeding to avoid tax claims under 11 U.S.C. 724(a).
  - Issue of whether the property is still “property of the estate” to allow the avoidance under 11 U.S.C. 550 and 551 despite the homestead amendments under RCW 6.13 et seq.

## Challenges to Washington’s New Homestead Bill (cont’d)

- *In re Stephen Lee Ates*, Case No. 21-41090-MJH
  - Objection based on
    - Unlawful delegation to the Washington Center for Real Estate Research to determine annual county median property values
    - Violation of the Administrative Procedures Act
    - Emergency Enactment was Unlawful
    - Equal Protection violation under the Washington State Constitution – Article I, Section 12 (Objection withdrawn)

## Challenges to Washington's New Homestead Bill (cont'd)

- *In re Cotton*, Case No. 21-40847-MJH
  - Case regarding whether homestead was limited due to 11 USC 522(p)(1)(A) and (D) due to a prior felony conviction
  - Question whether the homestead is limited to \$170,350 (issues still pending)

## Questions and Answers



### S5406, Washington's New Homestead Law<sup>1</sup>

On April 19, 2021 the Washington Legislature passed S5406 dealing with the Homestead law in the State of Washington. This article will deal with four (4) aspects of the law that practitioners need to know when the law becomes effective. The effective date is not yet known but the legislation contains an emergency clause that makes it effective upon signing by Governor Inslee.

1. The amount of the homestead is dramatically increased and is different in each county.

The Homestead amount is the greater of \$125,000 or the previous year's median value of a single-family residence. The amount is tied to the "Annual Median Price by County" records kept and published by the University of Washington Center for Real Estate Research - <https://wcrer.be.uw.edu/archived-reports/> which is found on the last tab.

The Bankruptcy Court Clerk's Office will provide a link to that number or on its court website. The actual relevant document can be found here: <https://wcrer.be.uw.edu/wp-content/uploads/sites/41/2021/02/2020Q4WSHMR.pdf> Page 23

Claiming the exemption on Schedule C presents a dilemma. In *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992), the Supreme Court held that listing the property with no value or unknown value put the trustee on notice and the property exited the estate if the trustee did not object to exemptions. In *Schwab v. Reilly (In re Reilly)*, — U.S. —, 130 S.Ct. 2652, 177 L.Ed.2d 234 (2010), the debtor scheduled some kitchen equipment at \$ and claimed the equipment exempt with a value of \$10,718. Justice Thomas, writing for the majority said that was not sufficient. The Court ruled that the debtor must claim "100% of Fair Market Value."

Subsequent cases have opined that the debtor must allocate the exemption so that the trustee can determine how much is being claimed exempt. *In re Salazar*, 449 B.R. 890, 901 (2011); *In re Massey*, 465 B.R. 720, 730 (2012); *In re Luckham*, 464 B.R. 67 76-77 (2012). Most software publishers do not allow this allocation and the attorney needs to think carefully before just allowing the software to choose a number.

The authors agree that the intent of the legislature was to make the entire property exempt. However, *In re Mwangi*, 764 F.3d 1168, 1175 (9th Cir. 2014), the court held:

We applied *Schwab's* holding in *In re Gebhart*. There, we considered two statutes that allow a debtor to exempt an interest in real property, the value of which may not exceed a certain dollar amount. *In re Gebhart*, 621 F.3d at 1210. Relying on *Schwab*, we held that "the fact that the value of the claimed exemption [was] ... equal to the market value of the residence at the time of filing the petition did not remove the entire asset from the estate." *Id.* "Instead, what [was] removed from the estate [was] an interest in the property equal to the value of the exemption." *Id.* (internal quotation marks omitted). As a result, the asset would remain estate property until it was administered in bankruptcy, the trustee abandoned the asset, or the bankruptcy case closed. *Id.* at 1210, 1212, 621 F.3d 1206; *see also Schwab*, 560 U.S. at 792, 130 S.Ct. 2652 ("Where a debtor intends to exempt nothing more

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<sup>1</sup> © Marc S. Stern ([www.chutzpahlaw.com](http://www.chutzpahlaw.com)) Christina Latta Henry 2021.

than an interest ... [and] an interested party does not object to the claimed interest ..., title to the asset will remain with the estate pursuant to § 541, and the debtor will be guaranteed a payment in the dollar amount of the exemption.").

*Mwangi* is a case for the wary. It might be that just claiming the exemption is sufficient. However, it might not be. The proper practice of law requires an attorney to know what is being filed and how exemptions are being claimed. Properly planning and claiming exemptions is one of the most important roles of the bankruptcy attorney. It is best not left to a computer programmer.

One case has clearly addressed what is necessary.

**A debtor must to do two things to exempt a 100% interest in an asset from the estate. First, she must check the box in the third column of Schedule C that corresponds with the text “100% of fair market value, up to any applicable statutory limit.” Second, she must assign a dollar value to her interest.**

Ms. Ayobami accomplished the second requirement by indicating the value of her interest in the assets in the fourth column of Schedule C.

The trustee may object to a debtor's claimed exemption. If the trustee lodges an objection, the court will hold an evidentiary hearing to determine the value of the claimed exemption of a 100% interest in the asset. Perhaps because the debtor's sworn schedules attest to the value of the interest, Fed. R. Bankr.P. 4003(c) imposes the burden of proof on the trustee to challenge the debtor's value. If the objection is overruled, the debtor's interest will be removed from the estate, and the estate retains only bare title to the asset. Any postpetition appreciation of the asset will go to the debtor. If the objection is sustained, the debtor will be required to amend his exemptions to comply with § 522. See *In re Moore*, 442 B.R. at 868. [Emphasis supplied.]

*In re Ayobami*, 15-35488, 2016 WL 3854052, at \*9 (Bankr. S.D. Tex. June 9, 2016), certified question answered sub nom. *In matter of Ayobami*, 879 F.3d 152 (5th Cir. 2018).

2. Post-petition appreciation is now exempt under state law.

In addition to providing a homestead exemption of the median price of a single-family house in the county, the legislature also specifically rejected the Ninth Circuit Ruling in *Wilson v. Rigby*, 909 F.3d 306, 309 (9th Cir. 2018). State law now provides that the exemption is determined on the date of filing and that appreciation after that date belongs to the debtor.

There are issues of what that means and whether there is a federal supremacy issue. We believe that Congress left the issues of exemption to the states and this provision is not subject to

attack. The Homestead Exemption Bill (ESSB 5408) brings Washington State’s exemption statute more in line with the legislature’s intentions than the Ninth Circuit’s interpretation of the statute in *Wilson v. Rigby*. While it is true that in *Wilson v. Rigby*, 909 F.3d 306, 309 (9th Cir. 2018), the court relied on 11 USC § 541(a) and 11 USC § 541(a)(1) to review RCW 6.13.070, the amendments to the homestead bill are intended to align with those specific statutes. Remember, however, that choosing a number instead of an asset may create unforeseen problems.

When it comes to exemptions, the bankruptcy code specifically allows states to opt out of the federal exemption scheme to implement their own exemptions under 11 USC 552(b). The US Supreme Court has also opined that the exemption delegation to states is broad, not limited in scope, and even allows a state not to enact any exemption scheme at all. *Owen v. Owen*, 500 U.S. 305, 308 (1991). Additionally, once a bankruptcy petition is filed, the transfer of rights to the estate is limited by the exemptions claimed. *Wilson*, 909 F.3d at 309. And it is widely accepted that property deemed exempt from a debtor's bankruptcy estate reverts in the debtor. *In re Smith*, 235 F.3d 472, 478 (9th Cir. 2000); *see also* 11 U.S.C. § 522(l). Simply put, and as the Ninth Circuit has explained, “Congress has not occupied the field of bankruptcy regulation to the point of preempting state exemption statutes.” *Sticka v. Applebaum (In re Applebaum)*, 422 B.R. 684, 689 (B.A.P. 9th Cir. 2009).

The effect in Chapter 13 is also a question.

Most recently, in *Black v. Leavitt (In re Black)*, 609 B.R. 518 (9th Cir. BAP 2019), we reaffirmed our view that the estate terminates at confirmation. We stated that “the revesting provision of the confirmed plan means that the debtor owns the property outright and that the debtor is entitled to any postpetition appreciation.” 609 B.R. at 529 (citing *In re Jones*, 420 B.R. at 515).

*In re Berkley*, 613 B.R. 547, 553 (B.A.P. 9th Cir. 2020)

3. A sale in Title 11 is a “forced sale” under the homestead statute.

The statute codifies Judge Barreca’s ruling in *In re Good*, 588 B.R. 573 (Bankr. W,D. Wash. 2018). Any sale in bankruptcy is now classified as a forced sale. This means that the one-year reinvestment provision does not apply. RCW 6.13.070.

The law now is that the homestead may be voluntarily sold, and the proceeds are exempt for one year to allow the homesteader to purchase a new property. When the new property is purchased, that property becomes the homestead.

Other courts have held that the homestead proceeds resulting from the trustee’s sale of property are only exempt for one year and must be reinvested. This was not the result in *Good*, *supra*, and the legislature has now codified that result. The proceeds of a sale under Title 11 remain exempt with no time limits.

4. Moving or getting a new homestead can be problematical.

Section 522(o) and (p) place limits on the homestead, currently \$170,360. But note §522(p)(2)(B) provides a safe harbor if moving within the state:

(B) For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215-day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State.

Additionally, the limitation does not apply to an exemption claimed on a principal residence by a family farmer.

There is an ambiguity in the phrase "interest that was acquired by the debtor" under section 522(p). The issue is what leads to "acquiring" an interest in a principal residence. Some courts argue that the homestead should not apply to an interest attributable simply to an increase in the market value of the debtor's homestead during the 1215-day period, because that is not an interest "acquired" by the debtor, but rather an increase in the value of the debtor's existing interest. *See, In re Greene*, 583 F.3d 614, 623 (9th Cir. 2009).

In the same vein, paying down the mortgage, or home improvements, do not increase the property interest that the debtor holds. *See, In re Elia*, 198 B.R. 588, 596 (Bankr. D. Ariz. 1996). However, care must be taken. If not done properly, defense of a dischargeability issue may ensue.

Generally, a Debtor's conversion of non-exempt property into exempt property on the eve of bankruptcy is not fraudulent per se. *In re Daniel*, 771 F.2d 1352 (9th Cir.1985); *In re Love*, 341 F.2d 680 (9th Cir.1965); *In re Summers*, 85 B.R. 121, 126 (Bankr. Or. 1988). Extrinsic evidence of fraud must be present to invalidate the exemption.

*In re Luthje*, 107 B.R. 292, 295 (Bankr. D. Mont. 1989).

**Links to Additional Material**

**Engrossed Substitute Senate Bill 5408**

<https://lawfilesexternal.wa.gov/biennium/2021-22/Pdf/Bills/Senate%20Passed%20Legislature/5408-S.PL.pdf>

**Memorandum**

*In re Wells*, No. 20-35984, 2021 WL 5755086 (9th Cir. Dec. 3, 2021)

<https://oregonstatebar.s3.us-west-2.amazonaws.com/Seminars/2022/NWB22-2A-1.pdf>

**Memorandum Decision**

*In re Castleman*, 631 B.R. 914, 917 (Bankr. W.D. Wash. 2021)

<https://oregonstatebar.s3.us-west-2.amazonaws.com/Seminars/2022/NWB22-2A-2.pdf>

**Opinion**

*In re Guevarra*, BAP No. EC-21-1141-SFL (9th Cir. B.A.P. March 25, 2022)

<https://oregonstatebar.s3.us-west-2.amazonaws.com/Seminars/2022/NWB22-2A-3.pdf>

**Order Overruling Trustee’s Objection to Debtor’s Homestead Exemption**

*In re Tangonan*, Case No. 21-11288

<https://oregonstatebar.s3.us-west-2.amazonaws.com/Seminars/2022/NWB22-2A-4.pdf>

**Complaint for (1) Declaratory Judgment, (2) Judgment Avoiding and Preserving and Recovering IRS Liens Securing Non-Pecuniary Tax Penalties and Interest on Penalties, and (3) Related Relief**

*Wood v. Wolf*, Adv Case No. 21-11757

<https://oregonstatebar.s3.us-west-2.amazonaws.com/Seminars/2022/NWB22-2A-5.pdf>

**Notice of Objection to Claim of Exemption**

*In re Stephen Lee Ates*, Case No. 21-41090-MJH

<https://oregonstatebar.s3.us-west-2.amazonaws.com/Seminars/2022/NWB22-2A-6.pdf>

**Order Granting Partial Summary Judgment on Debtors’ Motion to Avoid Lien**

*In re Cotton*, Case No. 21-40847-MJH

<https://oregonstatebar.s3.us-west-2.amazonaws.com/Seminars/2022/NWB22-2A-7.pdf>

**Memorandum Decision on Debtors’ Motion to Avoid Lien**

*In re Cotton*, Case No. 21-40847-MJH

<https://oregonstatebar.s3.us-west-2.amazonaws.com/Seminars/2022/NWB22-2A-8.pdf>



**Chapter 2B**  
**Selected Topics on Oregon Personal  
Property Exemptions**

**STEPHEN GINDLING**  
Todd Trierweiler & Associates  
Portland, Oregon

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**Selected Topics on Oregon Personal Property Exemptions**

**Stephen Gindling  
Todd Trierweiler & Associates**

**I. Personal Bodily Injury**

***Quesnoy v. Dep’t of Revenue, 286 Or.App. 359, 400 P.3d 960 (2017).*** The Debtor owed \$250,000 in restitution to the state, most of which was referred to ODR for collection. The Debtor subsequently won a \$35,000 judgment against the state for her treatment by the Coffee Creek Correctional Facility. Her claims against the state included: failure to accommodate her disabilities, retaliation, and 14<sup>th</sup> Amendment violation. She alleged humiliation, frustration, distress, physical pain, mental anguish, anxiety, and loss of her freedom. She testified about injuries sustained from falling twice, and her attorney requested compensation for physical injuries in closing arguments. ODR attempted to garnish. Debtor claimed personal injury exemption for \$10,000 of her judgment.

HELD: Debtor’s claim of exemption properly was denied, as the judgment did not specify which portion, if any, was for personal bodily injury.

***In re Cope, 280 B.R. 516 (Bankr.D Or. 2001).*** Debtor had a prepetition employment discrimination claim which the trustee settled. Debtor attempted to exempt \$10,000 of the recovery as recovery for “personal bodily injury.” Debtor argued that Oregon does not require actual physical injury to recover emotional distress damages.

HELD: Exemption denied. “Personal bodily injury” requires physical injury to the body as a prerequisite, even though it can include damages for pain and suffering that arise from that injury.

**II. Tools of the Trade**

***In re Lindsay, 29 B.R. 25 (Bankr.D.Or. 1983).*** Debtor claimed a Ford Mustang convertible as a Tool of the Trade. She used it only in a side job sewing swimsuits and delivering them to fairs and directly to customers.

HELD: Exemption denied. Vehicle must be “uniquely suited for and principally used in connection with a principal business activity.” Debtor did not claim any taxable income from the sewing business, and the vehicle was not uniquely suited for that business.

***In re Stewart, 83-03855-hlh7.*** Debtor, an unemployed police officer, claimed several handguns as Tools of the Trade.

HELD: Exemption upheld. Firearms are not necessary for him to gain employment as a police officer, they would constitute an asset for employment.

***In re Ficke, 85-07184-psw7.*** Debtor claimed a refrigerated dairy truck as a Tool of the Trade. He had used it for his dairy-delivery business for 3.5 years, but he quit that job 12 days before filing bankruptcy. He testified that he longer intended to deliver dairy products for a living, and instead intended to do yard work in the future.

HELD: Exemption denied.

***In re Dormer, 85-09150-psw7.*** Debtor used a tractor and a flatbed truck for his primary occupation, logging and cutting firewood.

HELD: Exemption upheld for the tractor. Exemption denied for flatbed truck because it was “not uniquely suited for or specially or uniquely equipped for the activity,” despite some modifications.

### **III. Professionally prescribed health aids**

***In re Driscoll, 179 B.R. 664 (Bankr.D.Or. 1995).*** Debtor had lost his right foot, and his prosthetic had no flexibility at the ankle. An occupational therapist reviewed his options for driving, and one option was to use a vehicle with a substantial amount of space above the pedals. Debtor found that he could operate his Lexus because of that reason.

HELD: Exemption denied. Debtor’s Lexus was not “uniquely suited and principally used as a health aid” because it was neither of the following (definition of “medical care” in I.R.C. §213(d)(1))

- “(A) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body, or
- (B) for transportation primarily for and essential to medical care...”

***In re Kirby, 223 B.R. 825 (Bankr.M.D.Fla 1998).*** Debtor lived in motor home that was modified, per doctor’s prescription, with hoist, ceiling track, monitoring system, and wheelchair access.

HELD: Exemption denied, as motor home was not “uniquely suited and principally used” for medical care.

***In re Allard*, 342 B.R. 102 (Bankr.M.D.Fla. 2005).** Debtor used a van that was modified with wheelchair lift to assist with her disability.

HELD: Exemption for full value of van allowed.

***In re Hellen*, 329 B.R. 678 (Bankr.N.D.Ill. 2005).** Paraplegic Debtor had his van professionally modified to add an accelerator, brake, and access modifications. It was his sole means of transportation, and the modifications made it unsafe for other drivers including those with different disabilities.

HELD: Exemption allowed only for the value of the modifications, not for the entire van.

***In re Reardon*, 403 B.R. 822 (Bankr.D.Mont. 2009).** Debtor, a single mother, was paralyzed from the waist down. She had her 2007 Dodge Grand Caravan modified with a lift/conversion kit. It was her sole means of transportation for work and childcare.

HELD: Exemption allowed for full value of van (\$35,000).

***In re Man*, 428 B.R. 644 (Bankr.M.D.N.C. 2010).** Debtor modified home to assist with environmental sensitivities.

HELD: Exemption allowed for \$11,000 of home improvements.

***In re Dowell*, 456 B.R. 578 (Bankr.M.D.Fla. 2011).** “Spinner” device attached (shortly before petition date) to steering wheel to assist disabled driver turn the vehicle. Debtor claimed the entire vehicle as exempt.

HELD: Exemption is allowed only for the spinner, and not the entire vehicle.

#### **IV. Annuities**

***In re Thompson*, 96-30581-el7.** Debtor received personal injury settlement funded by annuity taken out by insurance company, and claimed exemption as an annuity.

HELD: Annuity must be based on continuation of human life (ORS 731.154). Personal injury settlement funded by an annuity is not an annuity. Additionally, the insurer, not the debtor, was the annuitant.

## V. Retirement Accounts

***In re Bennett, 12-60642-tmr7.*** Debtor's self-settled money purchase pension plan appeared to be covered by I.R.C. §401(a) and therefore exempt under ORS 18.358(1)(d)(A).

HELD: Exemption denied. Debtor abused plan assets by making a series of prohibited transactions.

(See also ***In re Kees, 16-62660-tmr7***, for a thorough discussion of whether a retirement plan qualifies under I.R.C. §408.)

***In re Lucas, BAP No. OR 89-1503-AsVR (1990).*** As trustee of his two §401(a) plans, Debtor used funds for various personal expenses. Six months before filing bankruptcy, he resigned as trustee of both plans.

HELD: Exemption denied for funds contributed to plan prior to resignation, allowed for funds contributed after resignation.

***In re Wilbur, 126 F.3d 1218 (9<sup>th</sup> Cir. 1997).*** Debtor was owed \$16,000 from former domestic partner's PERS account, in recognition of her contributions to their joint retirement.

HELD: Exemption denied. Debtor never acquired an interest in the PERS account, and the money owed was not based on an employment relationship.

***In re Carlton, 00-40223-elp7.*** Debtor had been awarded one-half of her ex-husband's 401(k) in divorce decree, but had not obtained the QDRO before filing bankruptcy.

HELD: Exemption allowed. Debtor did not just have a general claim against her ex-husband. She had a claim against the plan, which was not enforceable until she obtained the QDRO. Furthermore, the right to obtain the QDRO was non-transferable under ERISA, and therefore the trustee could not release her right to obtain the QDRO.

## VI. Tracing Issues

***In re Smith, 96-64564-fra7.*** Debtor received a lump sum of \$13,180 in California workers' compensation benefits. She placed the funds in a bank account opened by her parents while retaining the equitable interest.

HELD: Funds are not exempt pursuant to ORS 656.234 because they were awarded by California workers' compensation statute. Exemption claim upheld as payments for personal bodily injury and/or lost wages, and they remain exempt if placed in relative's bank account (Resulting Trust).

***In re Platt, 270 B.R. 773 (Bankr.D.Or. 2001).*** Debtors held wages of \$6,870.31 in a segregated bank account on the date of filing, and claimed \$5,152.73 exempt under ORS 23.166 (now 18.348).

HELD: Exemption claim upheld since wages were reasonably identifiable.

***In re Drescher, 12-64729-tmr7.*** Debtor mixed federal student assistance with wages in her bank account, then withdrew both prior to bankruptcy.

HELD: Wages remain wages even if reduced to cash, and even if run through a bank account first. Federal student assistance is also fully exempt, under 20 U.S.C. §1095a(d), if traceable to bank account, and even if reduced to cash.



**18.345 Exempt personal property generally.** (1) All property, including franchises, or rights or interest therein, of the judgment debtor, shall be liable to an execution, except as provided in this section and in other statutes granting exemptions from execution. The following property, or rights or interest therein of the judgment debtor, except as provided in ORS 18.305, shall be exempt from execution:

(a) Books, pictures and musical instruments to the value of \$600.

(b) Wearing apparel, jewelry and other personal items to the value of \$1,800.

(c) The tools, implements, apparatus, team, harness or library, necessary to enable the judgment debtor to carry on the trade, occupation or profession by which the judgment debtor habitually earns a living, to the value of \$5,000.

(d) A vehicle to the value of \$3,000. As used in this paragraph “vehicle” includes an automobile, truck, trailer, truck and trailer or other motor vehicle.

(e) Domestic animals and poultry kept for family use, to the total value of \$1,000 and food sufficient to support such animals and poultry for 60 days.

(f) Household goods, furniture, radios, a television set and utensils all to the total value of \$3,000, if the judgment debtor holds the property primarily for the personal, family or household use of the judgment debtor; provisions actually provided for family use and necessary for the support of a householder and family for 60 days and also 60 days’ supply of fuel.

(g) All property of the state or any county or incorporated city therein, or of any other public or municipal corporation of like character.

(h) All professionally prescribed health aids for the debtor or a dependent of the debtor.

(i) Spousal support, child support, or separate maintenance to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

(j) The debtor’s right to receive, or property that is traceable to, an award under any crime victim reparation law.

(k) The debtor’s right to receive, or property that is traceable to, a payment or payments, not to exceed a total of \$10,000, on account of personal bodily injury of the debtor or an individual of whom the debtor is a dependent.

(L) The debtor’s right to receive, or property that is traceable to, a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

(m) Veterans’ benefits and loans.

(n) The debtor’s right to receive an earned income tax credit under the federal tax laws and any moneys that are traceable to a payment of an earned income tax credit under the federal tax laws.

(o) The debtor’s right to the assets held in, or right to receive payments under, a medical savings account or health savings account authorized under section 220 or 223 of the Internal Revenue Code.

(p) The debtor’s interest, not to exceed \$400 in value, in any personal property. However, this exemption may not be used to increase the amount of any other exemption.

(2) If the property claimed by the judgment debtor as exempt is adjudicated by the court out of which the execution issued to be of a value in excess of that allowed by the appropriate paragraph of subsection (1) of this section, the officer seizing the property shall proceed to sell such property. Out of the proceeds of such sale, the officer shall deduct costs of sale and shall pay to the judgment debtor an amount equivalent to the value declared to be exempt by any of

the paragraphs of subsection (1) of this section and shall apply the balance of the proceeds of sale on the execution. A sale may not be made under such execution unless the highest bid made exceeds the appropriate exemption claimed and allowed plus costs of sale. If no bid is received in excess of the value allowed by the appropriate paragraph of subsection (1) of this section, the costs of sale shall be borne by the judgment creditor.

(3) If two or more members of a household are joint judgment debtors, each judgment debtor shall be entitled to claim the exemptions in subsection (1)(a), (b), (c), (d) and (p) of this section in the same or different properties. The exemptions provided by subsection (1)(a), (b), (c), (d), (j), (k) and (p) of this section, when claimed for jointly owned property, may be combined at the option of the debtors.

(4) Notwithstanding any other provision of law except ORS 657.855, if a writ of garnishment or other execution is issued to collect past due support as defined in ORS 18.600, 50 percent of unemployment compensation benefits, workers' compensation benefits and other benefits paid to the debtor by the United States, by the state or by a political subdivision of the state are exempt. The exemption related to unemployment compensation benefits provided by this subsection is subject to ORS 657.855. The exemption provided by this subsection applies without regard to whether the payment is made on a periodic basis or in a lump sum, including any lump sum payable pursuant to a settlement or judgment. Notwithstanding subsection (1)(k) of this section, if a payment is made under a settlement or judgment on account of personal bodily injury and the garnishment or other execution is issued to collect past due support as defined in ORS 18.600, the lesser of 50 percent of the payment or \$7,500 is exempt. [Formerly 23.160; 2005 c.456 §1; 2009 c.612 §1; 2011 c.93 §1; 2011 c.317 §4; 2013 c.597 §1]

**18.348 Certain funds exempt when deposited in account; limitation.** (1) Funds that are exempt from execution under ORS 18.358, 18.385, 178.345, 238.445, 344.580, 407.595, 411.760, 414.095, 655.530, 656.234, 657.855 and 748.207 remain exempt when deposited in an account in a financial institution as long as the exempt funds are reasonably identifiable.

(2) Subsection (1) of this section does not apply to any accumulation of funds greater than \$7,500.

(3) All funds that are exempt under federal law remain exempt when deposited in an account in a financial institution as long as the exempt funds are reasonably identifiable.

(4) The application of subsections (1) and (3) of this section is not affected by the commingling of exempt and nonexempt funds in an account. For the purpose of identifying exempt funds in an account, first in, first out accounting principles shall be used.

(5) The provisions of this section do not affect the duties of a garnishee with respect to amounts in accounts that are not subject to garnishment under ORS 18.784. [Formerly 23.166; 2005 c.381 §19; 2009 c.430 §4; 2009 c.718 §37]

*18.358: retirement plans*

*18.385: wages*

*178.345: 529 plan*

*238.445: PERS benefits*

*344.580: career/technical education payments*

*407.595: Veterans' loans*

*411.760: public assistance*

*414.095: medical assistance*

655.530: *payments to adults in custody*

656.234: *workers compensation*

657.855: *unemployment*

748.207: *fraternal society benefit payments*

**ORS 18.358 Certain retirement plans exempt from execution** (1) As used in this section:

(a) “Beneficiary” means a person for whom retirement plan benefits are provided or their spouse.

(b) “Internal Revenue Code” means the federal Internal Revenue Code as amended and in effect on December 31, 1998.

(c) “Permitted contribution” means:

(A) A contribution that, at the time of the contribution, is not taxable income to the beneficiary and, if the sponsor is a taxable entity, is tax deductible to the sponsor;

(B) A nondeductible contribution by a beneficiary to a retirement plan to the extent that the contribution is permitted to be made under the Internal Revenue Code;

(C) A deductible or nondeductible contribution to an individual retirement account to the extent the contribution is not subject to federal excise tax as an excess contribution;

(D) A contribution, pursuant to a rollover or transfer, from one retirement plan to another, to the extent the federal tax deferred status is preserved at such time;

(E) A rollover from an individual retirement account described in section 408 of the Internal Revenue Code to an individual retirement account described in section 408A of the Internal Revenue Code; and

(F) Any earnings under a retirement plan that are attributable to a contribution described in subparagraphs (A) to (E) of this paragraph.

(d) “Retirement plan” means:

(A) A pension plan and trust, including a profit sharing plan, that is described in sections 401(a), 401(c), 401(k), 403 and 457 of the Internal Revenue Code, including that portion attributable to contributions made by or attributable to a beneficiary;

(B) An individual retirement account or annuity, including one that is pursuant to a simplified employee pension, as described in section 408 or 408A of the Internal Revenue Code; and

(C) Any pension not described in subparagraphs (A) and (B) of this paragraph granted to any person in recognition or by reason of a period of employment by or service for the Government of the United States or any state or political subdivision of any state, or any municipality, person, partnership, association or corporation.

(e) “Sponsor” means an individual or entity that establishes a retirement plan.

(2) Subject to the limitations set forth in subsection (3) of this section, a retirement plan shall be conclusively presumed to be a valid spendthrift trust under these statutes and the common law of this state, whether or not the retirement plan is self-settled, and a beneficiary’s interest in a retirement plan shall be exempt, effective without necessity of claim thereof, from execution and all other process, mesne or final.

**18.385 Wage exemption.** (1) Except as provided in this section, 75 percent of the disposable earnings of an individual are exempt from execution.

(2) The disposable earnings of an individual are exempt from execution to the extent that payment under a garnishment would result in net disposable earnings for an individual of less than the following amounts:

- (a) \$254 for any period of one week or less;
- (b) \$509 for any two-week period;
- (c) \$545 for any half-month period;
- (d) \$1,090 for any one-month period; and

(e) For any other period longer than one week, \$254 multiplied by that fraction produced by dividing the number of days for which the earnings are paid by seven. The amount calculated under this paragraph must be rounded to the nearest dollar.

(3) If an individual is paid for a period shorter than one week, the exemption calculated under subsection (2) of this section may not exceed \$254 for any one-week period.

(4) An employer shall deduct from the amount of disposable earnings determined to be nonexempt under subsections (1) to (3) of this section any amounts withheld from the individual's earnings for the same period of time under an order issued pursuant to ORS 25.378 or 419B.408 or ORS chapter 110. The employer shall make payment under a garnishment only of those amounts remaining after the deduction is made.

(5) Subsections (1) to (4) of this section do not apply to:

- (a) Any order of a court of bankruptcy.
- (b) Any debt due for federal tax.

(6) Subsections (2) to (4) of this section do not apply to any debt due for state tax. Subsection (1) of this section does not apply to a debt due for state tax if a state agency issues a special notice of garnishment under ORS 18.855 (6).

(7) A court may not make, execute or enforce any order or process in violation of this section.

(8) Any waiver by an individual of the provisions of this section is void.

(9) An employer may not discharge any individual because the individual has had earnings garnished. [Formerly 23.186; 2007 c.496 §§9,14; 2011 c.228 §1; 2019 c.263 §1; 2021 c.597 §41]

**743.046 Exemption of proceeds of individual life insurance other than annuities.** (1) When a policy of insurance is effected by any person on any person's own life or on another life in favor of some person other than that person having an insurable interest in the life insured, the lawful beneficiary thereof, other than that person or that person's legal representative, is entitled to its proceeds against the creditors or representatives of the person effecting the policy.

(2) The person to whom a policy of life insurance is made payable may maintain an action thereon in the person's own name.

(3) A policy of life insurance payable to a beneficiary other than the estate of the insured, having by its terms a cash surrender value available to the insured, is exempt from execution issued from any court in this state and in the event of bankruptcy of such insured is exempt from all demands in legal proceeding under such bankruptcy.

(4) Subject to the statute of limitations, the amount of any premiums paid in fraud of creditors for such insurance, with interest thereon, shall inure to their benefit from the proceeds of the policy. The insurer issuing the policy shall be discharged of all liability thereon by payment of its proceeds in accordance with its terms unless, before such payment, the insurer has received at its home office written notice by or in behalf of some creditor, with specifications of the amount claimed, claiming to recover for certain premiums paid in fraud of creditors.

(5) The insured under any policy within this section shall not be denied the right to change the beneficiary when such right is expressly reserved in the policy.

(6) This section does not apply to annuity policies. [Formerly 739.405 and then 743.099]

**743.047 Exemption of proceeds of group life insurance.** (1) A policy of group life insurance or the proceeds thereof payable to a person or persons other than the individual insured or the individual's estate shall be exempt from debts and claims of creditors or representatives of the individual insured and, in the event of bankruptcy of the individual insured, from all demands in legal proceedings under such bankruptcy.

**ORS 743.049 Exemption of proceeds of annuity policies.** (1) The benefits, rights, privileges and options which are due or prospectively due an annuitant under any annuity policy issued before, on or after June 8, 1967, shall not be subject to execution, nor shall the annuitant be compelled to exercise any such rights, powers or options, nor shall creditors be allowed to interfere with or terminate the policy, except:

(a) As to amounts paid for or as premium on any such annuity with intent to defraud creditors, with interest thereon, and of which the creditor has given the insurer written notice at its home office prior to the making of the payments to the annuitant out of which the creditor seeks to recover. Any such notice shall specify the amount claimed or such facts as will enable the insurer to ascertain such amount, and shall set forth such facts as will enable the insurer to ascertain the annuity policy, the annuitant and the payments sought to be avoided on the ground of fraud.

(b) The total exemption of benefits presently due and payable to any annuitant periodically or at stated times under all annuity policies under which the person is an annuitant shall not at any time exceed \$500 per month for the length of time represented by such installments. Such periodic payments in excess of \$500 per month shall be subject to garnishee execution to the same extent as are wages and salaries.

(c) If the total benefits presently due and payable to any annuitant under all annuity policies under which the person is an annuitant shall at any time exceed payment at the rate of \$500 per month, the court may order such annuitant to pay to a judgment creditor or apply on the judgment, in installments, the portion of such excess benefits as to the court may appear just and proper, after due regard for the reasonable requirements of the judgment debtor and family, if dependent upon the judgment debtor, as well as any payments required to be made by the annuitant to other creditors under prior court orders.

(2) If the policy so provides, the benefits, rights, privileges or options accruing under the policy to a beneficiary or assignee shall not be transferable nor subject to commutation, and if the benefits are payable periodically or at stated times, the same exemptions and exceptions contained in this section for the annuitant shall apply with respect to such beneficiary or assignee.



## Chapter 3A

# Third-Party Releases: Perspectives on *Purdue Pharma*

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**THIRD-PARTY RELEASES:  
PERSPECTIVES ON *PURDUE PHARMA***

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*Northwest Bankruptcy Institute, May 12, 2022*

**A. FACTS AND PROCEDURAL POSTURE**

1. Claimants' numbers and severity and disparity of positions are unprecedented
  - a. 48 states and territories; hospitals; victims of neo-natal abstinence syndrome; rate payors; Native American tribes; and Canadian tribes; school districts; etc.
  - b. Personal injury claimants with and without prescriptions; fatalities; unemployment; etc.
2. Sacklers' positions with the company; wealth; asset protection arrangements
3. U.S. government has \$2 billion superpriority claim
4. Bankruptcy Court ruling: In re Purdue Pharma L.P., 633 B.R. 53 (Bankr. S.D.N.Y. 2021)
  - a. Confirmation of plan of reorganization
    - i. Releases Sackler defendants in return for \$4.5 billion contribution to WHAT
    - ii. Sackler contribution largely goes to states for abatement measures
    - iii. Documentation for future studies
    - iv. U.S. Government's superpriority claim is released to extent \$1.775 billion
  - b. Objections by eight states, a small number of other claimants, and Canadian tribes are overruled
  - c. Process
    - i. Two professional mediators including Kenneth R. Feinberg
    - ii. Second stage of mediation with a third professional mediator
    - iii. Independent examiner appointed to prevent self-interested negotiation by Sacklers
    - iv. Two tort claimants sat on Official Committee of Unsecured Creditors
    - v. Personal testimony by tort claimants
    - vi. Several ad hoc committees
5. District Court reverses the confirmation of the plan: In re Purdue Pharma, L.P., 635 B.R. 26 (S.D.N.Y. 2021)
  - a. Settlement involving increased Sackler contribution to total of roughly \$6 billion is approved, subject to outcome of this current litigation
6. Second Circuit oral argument was April 29, 2022
  - a. Audio available at <https://www.ca2.uscourts.gov>
7. Outlook if Second Circuit upholds District Court ruling
  - a. Class action certification unlikely
    - i. Even for basic individual tort victims
  - b. Burden of individual litigation
    - i. Personal jurisdiction issues

- ii. Asset protection arrangements
- c. Enforcement hurdles:
  - i. Familiar race of diligence with limited funds available
  - ii. \$1.775 billion superpriority claim is revived

## B. EXISTING LAW

1. 11 U.S.C. § 524(g), dating from 1994.
  - a. Purpose is to uphold stability of existing Manville channeling injunction dating from the 1980s.
    - i. Congress notes “singular and cumulative magnitude” of claims in Manville case
  - b. Covers asbestos-related proceedings only
    - i. No express bar to similar arrangements in other proceedings
    - ii. Is a negative implication intended?
      1. District Court writes, “All parties agree that one and only one section of the Bankruptcy Code *expressly* authorizes a bankruptcy court to enjoin third party claims against non-debtors without the consent of those third parties. That section is 11 U.S.C. § 524(g), which was passed by Congress in 1994. It provides for such an injunction *solely and exclusively* in cases involving injuries arising from the manufacture and sale of asbestos.” 635 B.R. at 91 (emphasis added)
      2. [Resorts Int’l, Inc. v. Lowenschuss \(In re Lowenschuss\)](#), 67 F.3d 1394, 34 C.B.C.2d 544 (9th Cir. 1995), cert. denied, 517 U.S. 1243, 116 S. Ct. 2497, 135 L. Ed. 2d 189 (1996) (that Congress provided explicit authority to issue injunctions in favor of the third parties in an extremely limited class of cases reinforces the conclusion that section 524(e) denies such authority in other, non-asbestos cases).
      3. Subsection (h)(1) expressly avoids casting doubt on injunctions issued before enactment of subsection (g)
        - a. Subsection (h)(1) provides that the existence of section 524(g) does not mean that plans that were confirmed before the enactment of that section that are generally in conformity with it are unlawful.
      4. The legislation enacting Section 524(g) contained a “rule of construction”: ““Rule of Construction -- Nothing in subsection (a), or in the amendments made by subsection (a), shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization.” Pub. L. No. 103-394, § 111(b)
        - a. “[t]his language was apparently intended to prevent a negative implication from being drawn from the fact that the amendments deal only with asbestos-related cases.” 4 Collier on Bankruptcy P 524.07 (16<sup>th</sup> 2022)

- b. The legislative history makes the same point: that the asbestos rule “is not intended to alter any authority bankruptcy courts may already have to issue injunctions in connection with a plan of reorganization . . . [O]ther debtors in other industries are reportedly beginning to experiment with similar mechanisms. The Committee expressed no opinion as to how much authority a bankruptcy court may generally have under its traditional equitable powers to issue an enforceable injunction of this kind. The Committee has decided to provide explicit authority in the asbestos area because of the singular and cumulative magnitude of the claims involved. How the new statutory mechanism works in the asbestos area may help the Committee judge whether the concept should be extended into other areas.”” H.R. Rep. 103-834, 103d Cong., 2nd Sess. 12; 140 Cong. Rec. H10765 (Oct. 4, 1994).
        - c. The District Court in *Purdue* interpreted the use of “may” in the third sentence to suggest that it is “at best uncertain” whether bankruptcy courts had the authority to enter such injunctions.
        - d. The District Court focused on the last sentence of the legislative history to find that Congress reserved for *itself*, not the courts, the ability to extend the 524(g) injunction to non-asbestos cases.
2. 11 U.S.C. § 105(a): “The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.”
    - a. Possible other “provisions of this title”:
      - i. The Bankruptcy Court relied upon *Airadigm Communs., Inc. v. FCC (In re Airadigm Communs., Inc.)*, 519 F.3d 640 (7<sup>th</sup> Cir. 2008), where the Seventh Circuit considered § 1123(b)(6) together with § 105(a) and the bankruptcy court’s “traditionally broad” equitable powers to find “residual authority” for the bankruptcy court to release third parties where the release is “appropriate” and “not inconsistent with any provision of the Bankruptcy Code.”
      - ii. The court also relied on *Lynch v. Lapidem Ltd. (In re Kirwan Offices S.A.R.L.)*, 592 B.R. 489 (S.D.N.Y. 2018), which itself looks at §§ 1129(a)(1), 1123(a)(5) and (b)(6), 105, and 524(e) as a whole to find that the releases “flow from a federal statutory scheme.”
      - iii. The District Court address the statutes individually rather than as an organic whole.
        1. § 1123 (contents of plan), subsection (b)(6) provides that plan may “include any other appropriate provision not inconsistent with the applicable provisions of this title.”
          - a. Does this mean that the burden of finding an on-point Code provision falls on those opposing the releases, rather than on those supporting them?

- b. If so, is § 524(e) inconsistent?: “discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.”
    - i. Principal application is to cases such as sureties
    - ii. District Court does not agree with appellants that 523(e) is inconsistent.
  - c. Similar question with § 523 (exceptions to discharge)
    - i. Fraud; willful and malicious injury; penalties payable to and for the benefit of a governmental unit
    - ii. The District Court found the releases inconsistent with these nondischargeability provisions
    - iii. But, distinction between a discharge and a release
      1. *In re Dow Corning Corp.*, 280 F.3d at 657 (section 524(e) “explains the effect of a debtor's discharge. It does not prohibit the release of a non-debtor”)
      2. See also *Macarthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 91 (7th Cir. 1988) (distinguishing a bankruptcy discharge or a final determination on the merits from a settlement of claims; *Lynch v. Lapidem (In re Kirwan Offices S.à.r.l.)*, 592 B.R. 489, 504-05 (S.D.N.Y. 2018) (same).
      3. Note that § 524(g) requires favorable votes by 75% of the claimants in the relevant class
  2. § 1123(a)(5) provides that a plan of reorganization must “provide adequate means for [its] implementation.”
    - a. District Court rejects this as “independent” statutory authority for granting non-debtor releases.
  3. §1129(a)(1) provides that a bankruptcy court “shall confirm a plan only if . . . the plan complies with the applicable provisions of this title.”
    - a. District Court finds no independent statutory authority
  4. Other possible sources: § 362(a) (automatic stay), in the context of a debtor’s directors and officers or § 1141 (effect of confirmation)
3. Split in the circuits
- a. Majority of circuits to have considered the issue have approved releases and injunctions in narrow circumstances. See *Monarh Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973, 984-85 (1<sup>st</sup> Cir. 1995); *Deutsche Bank A.G. v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F. 3d 136, 141 (2d Cir. 2005); *Macarthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 93-94 (2d Cir. 1988); *In re Drexel Burnham Lambert Group*, 960 F.2d 285, 293 (2d Cir. 1992); *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126, 133-40 (3d Cir. 2019); *Nat’l Heritage Found., Inc. v. Highbourne Found., Inc.*, 760 F. 3d 344, 350 (4<sup>th</sup> Cir. 2014), cert. denied, 574 U.S. 1076, 135 S. Ct. 961, 190 L. Ed. 2d 833 (2015), and *Menard-Sanford v. Mabey (In re A.H. Robins Co.)*, 880 F.2d 694, 700-02 (4<sup>th</sup> Cir. 1989); *Class Five Nev.*

Claimants v. Dow Corning Corp. (In re Dow Corning Corp.), 280 F.3d 648, 661 (6<sup>th</sup> Cir. 2002); In re Airadigm Communs., 519 F.3d 655-56 and In re Ingersoll, Inc., 562 F.3d 856 (7<sup>th</sup> Cir. 2009); SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying (In re Seaside Eng'g & Surveying), 780 F.3d 1070, 1076-79 (11<sup>th</sup> Cir. 2015), cert. denied Vision-Park Props. v. Seaside Eng'g & Surveying, 577 U.S. 823, 136 S. Ct. 109, 193 L. Ed. 2d 37 (2015); and In re AOV Indus., Inc., 792 F.2d 1140, 1153, 253 U.S. App. D.C. 186 (D.C. Cir. 1986).

- i. District Court distinguished these cases for various reasons.
  - b. Three circuits have found that the bankruptcy court lacks the authority to grant these releases, largely based on 524(e). See Bank of New York Tr. Co., NA v. Off. Unsecured Creditors' Comm. (In re Pacific Lumber Co.), 584 F.3d 229, 252 (5<sup>th</sup> Cir. 2009); Resorts Int'l v. Lowenschuss (in re Lowenschuss), 67 F.3d 1394, 1401-02 (9<sup>th</sup> Cir. 1995); In re W. Real Estate Fund, 992 F.2d 592, 600 (10<sup>th</sup> Cir. 1990).
  - c. The Ninth Circuit has more recently held that a third-party release could, in appropriate circumstances, be imposed in a plan. Blixseth v. Credit Suisse, 961 F.3d 1074, 1081-85 (9<sup>th</sup> Cir. 2020).
  - d. Supreme Court has denied cert on these questions 3 times; would existence of a split influence decision to take up this case?
4. Supreme Court precedent
- a. District Court relied upon Supreme Court cases it found germane to the analysis:
    - i. RadLAX Gateway Hotel, LLC v. Amagamated Bank, 566 U.S. 639, 645, 132 S. Ct. 2065, 182 L. Ed. 2d 967 (2012).
    - ii. Law v. Siegel, 571 U.S. 415, 134 S. Ct. 1188, 188 L. Ed. 2d 146 (2014).
    - iii. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 197 L. Ed. 2d 398 (2017).
  - b. What about Butner v. United States, 440 U.S. 48 (1979)?

### C. SELECTED COMMENTARIES AND GOVERNMENTAL ACTIONS

1. Lindsey D. Simon, *Bankruptcy Grifters*, 131 Yale L.J. 1154 (2022) (critiquing third-party releases but ultimately calling for increased disclosure requirements and other safeguards)
2. Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 Tex. L. Rev. (forthcoming 2022) (finding third-party releases unconstitutional)
  - a. Original understanding of Article I, § 8 (the Bankruptcy Clause)
  - b. Due process right of adjudication before an Article III court
    - i. Compare Patterson v. Mahwah Bergen Retail Grp., Inc., 60 B.R. 641 (E.D. Va. 2022)
  - c. Ripeness
    - i. See also Adam J. Levitin, *The Constitutional Problem of Nondebtor Releases in Bankruptcy*, (forthcoming 91 Fordham L. Rev. (2022)), available at SSRN: <https://ssrn.com/abstract=4082234> or <http://dx.doi.org/10.2139/ssrn.4082234>

- ii. See also Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, 80 Am. Bankr. L.J. 1 (2006)
3. Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 Yale L.J. F. 960 (2022) (asserting that the Simon proposal does not go far enough; finding third-party releases unconstitutional, including by reference to separation of powers and *Erie* doctrine; and urging the Supreme Court to resolve the circuit split)
4. Biden Administration actions have been limited in scope
5. Proposed Nondebtor Release Prohibition Act
  - a. Sponsored by Senator Elizabeth Warren and Representative Jerrold Nadler
    - i. <https://www.congress.gov/117/bills/hr4777/BILLS-117hr4777ih.xml>.
  - b. Would require unanimous consent by those whose claims are being released.
    - i. Fundamental economics of “holdouts”
  - c. Provides for appeal directly to the U.S. Court of Appeals

#### D. ADDITIONAL PERSPECTIVES

1. Bankruptcy courts compared to other actors
  - a. Situated as early responders to slow-rolling social catastrophes
    - i. Massively underwater mortgage loans
    - ii. Student loans
    - iii. Medical bankruptcies
    - iv. In this case, intersection of addiction, poverty, inadequacies of medical care, criminal consequences to some victims
  - b. Inherently out in front of established law
    - i. Stephen Breyer remark: “Business law is being made in the bankruptcy courts.”
2. Natural for action by one judge to attract attention, irrespective of the particulars
  - a. Salience as a cognitive matter
3. High-level analogies
  - a. DIP financing under § 364
    - i. Split in circuits on whether to permit cross-collateralization in which post-petition collateral secures pre-petition debt
      1. Where not permitted, debtor’s immediate need for financing may not be met and reorganization may not succeed
      2. Even where not permitted, creative DIP lenders will have other “asks” such as rollups
  - b. Detroit, Michigan Chapter 9 proceeding
    - i. Ford Foundation
    - ii. Leveraging the State of Michigan to contribute

LINKS TO *PURDUE PHARMA* DECISIONS

*In re Purdue Pharma L.P.*, 633 B.R. 53 (Bankr. S.D.N.Y. 2021)

<https://oregonstatebar.s3.us-west-2.amazonaws.com/Seminars/2022/NWB22-3A-1.pdf>

*In re Purdue Pharma, L.P.*, 635 B.R. 26 (S.D. N.Y. 2021)

<https://oregonstatebar.s3.us-west-2.amazonaws.com/Seminars/2022/NWB22-3A-2.pdf>



**STATUTORY SUPPLEMENT TO “THIRD-PARTY RELEASES:  
PERSPECTIVES ON *PURDUE PHARMA*”**

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**Section 105(a)**

- (a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

**Section 524 (e)**

Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.

**Section 524(g)**

(g)

(1)

(A) After notice and hearing, a court that enters an order confirming a plan of reorganization under chapter 11 may issue, in connection with such order, an injunction in accordance with this subsection to supplement the injunctive effect of a discharge under this section.

(B) An injunction may be issued under subparagraph (A) to enjoin entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery with respect to any claim or demand that, under a plan of reorganization, is to be paid in whole or in part by a trust described in paragraph (2)(B)(i), except such legal actions as are expressly allowed by the injunction, the confirmation order, or the plan of reorganization.

(2)

(A) Subject to subsection (h), if the requirements of subparagraph (B) are met at the time an injunction described in paragraph (1) is entered, then after entry of such injunction, any proceeding that involves the validity, application, construction, or modification of such injunction, or of this subsection with respect to such injunction, may be commenced only in the district court in which

such injunction was entered, and such court shall have exclusive jurisdiction over any such proceeding without regard to the amount in controversy.

(B) The requirements of this subparagraph are that—

(i) the injunction is to be implemented in connection with a trust that, pursuant to the plan of reorganization—

(I) is to assume the liabilities of a debtor which at the time of entry of the order for relief has been named as a defendant in personal injury, wrongful death, or property-damage actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products;

(II) is to be funded in whole or in part by the securities of 1 or more debtors involved in such plan and by the obligation of such debtor or debtors to make future payments, including dividends;

(III) is to own, or by the exercise of rights granted under such plan would be entitled to own if specified contingencies occur, a majority of the voting shares of—

(aa) each such debtor;

(bb) the parent corporation of each such debtor; or

(cc) a subsidiary of each such debtor that is also a debtor;  
and

(IV) is to use its assets or income to pay claims and demands; and

(ii) subject to subsection (h), the court determines that—

(I) the debtor is likely to be subject to substantial future demands for payment arising out of the same or similar conduct or events that gave rise to the claims that are addressed by the injunction;

(II) the actual amounts, numbers, and timing of such future demands cannot be determined;

(III) pursuit of such demands outside the procedures prescribed by such plan is likely to threaten the plan's purpose to deal equitably with claims and future demands;

(IV) as part of the process of seeking confirmation of such plan—

(aa) the terms of the injunction proposed to be issued under paragraph (1)(A), including any provisions barring actions against third parties pursuant to paragraph (4)(A), are set out in such plan and in any disclosure statement supporting the plan; and

(bb) a separate class or classes of the claimants whose claims are to be addressed by a trust described in clause (i) is established and votes, by at least 75 percent of those voting, in favor of the plan; and

(V) subject to subsection (h), pursuant to court orders or otherwise, the trust will operate through mechanisms such as structured, periodic, or supplemental payments, pro rata distributions, matrices, or periodic review of estimates of the

numbers and values of present claims and future demands, or other comparable mechanisms, that provide reasonable assurance that the trust will value, and be in a financial position to pay, present claims and future demands that involve similar claims in substantially the same manner.

(3)

(A) If the requirements of paragraph (2)(B) are met and the order confirming the plan of reorganization was issued or affirmed by the district court that has jurisdiction over the reorganization case, then after the time for appeal of the order that issues or affirms the plan—

(i) the injunction shall be valid and enforceable and may not be revoked or modified by any court except through appeal in accordance with paragraph (6);

(ii) no entity that pursuant to such plan or thereafter becomes a direct or indirect transferee of, or successor to any assets of, a debtor or trust that is the subject of the injunction shall be liable with respect to any claim or demand made against such entity by reason of its becoming such a transferee or successor; and

(iii) no entity that pursuant to such plan or thereafter makes a loan to such a debtor or trust or to such a successor or transferee shall, by reason of making the loan, be liable with respect to any claim or demand made against such entity, nor shall any pledge of assets made in connection with such a loan be upset or impaired for that reason;

(B) Subparagraph (A) shall not be construed to—

(i) imply that an entity described in subparagraph (A)(ii) or (iii) would, if this paragraph were not applicable, necessarily be liable to any entity by reason of any of the acts described in subparagraph (A);

(ii) relieve any such entity of the duty to comply with, or of liability under, any Federal or State law regarding the making of a fraudulent conveyance in a transaction described in subparagraph (A)(ii) or (iii); or

(iii) relieve a debtor of the debtor's obligation to comply with the terms of the plan of reorganization, or affect the power of the court to exercise its authority under sections [1141](#) and [1142](#) to compel the debtor to do so.

(4)

(A)

(i) Subject to subparagraph (B), an injunction described in paragraph (1) shall be valid and enforceable against all entities that it addresses.

(ii) Notwithstanding the provisions of section 524(e), such an injunction may bar any action directed against a third party who is identifiable from the terms of such injunction (by name or as part of an identifiable group) and is alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor to the extent such alleged liability of such third party arises by reason of—

(I) the third party's ownership of a financial interest in the debtor, a past or present affiliate of the debtor, or a predecessor in interest of the debtor;

(II) the third party's involvement in the management of the debtor or a predecessor in interest of the debtor, or service as an officer, director or employee of the debtor or a related party;

(III) the third party's provision of insurance to the debtor or a related party; or

(IV) the third party's involvement in a transaction changing the corporate structure, or in a loan or other financial transaction affecting the financial condition, of the debtor or a related party, including but not limited to—

(aa) involvement in providing financing (debt or equity), or advice to an entity involved in such a transaction; or

(bb) acquiring or selling a financial interest in an entity as part of such a transaction.

(iii) As used in this subparagraph, the term "related party" means—

(I) a past or present affiliate of the debtor;

(II) a predecessor in interest of the debtor; or

(III) any entity that owned a financial interest in—

(aa) the debtor;

(bb) a past or present affiliate of the debtor; or

(cc) a predecessor in interest of the debtor.

(B) Subject to subsection (h), if, under a plan of reorganization, a kind of demand described in such plan is to be paid in whole or in part by a trust described in paragraph (2)(B)(i) in connection with which an injunction described in paragraph (1) is to be implemented, then such injunction shall be valid and enforceable with respect to a demand of such kind made, after such plan is confirmed, against the debtor or debtors involved, or against a third party described in subparagraph (A)(ii), if—

(i) as part of the proceedings leading to issuance of such injunction, the court appoints a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands of such kind, and

(ii) the court determines, before entering the order confirming such plan, that identifying such debtor or debtors, or such third party (by name or as part of an identifiable group), in such injunction with respect to such demands for purposes of this subparagraph is fair and equitable with respect to the persons that might subsequently assert such demands, in light of the benefits provided, or to be provided, to such trust on behalf of such debtor or debtors or such third party.

(5) In this subsection, the term "demand" means a demand for payment, present or future, that—

(A) was not a claim during the proceedings leading to the confirmation of a plan of reorganization;

(B) arises out of the same or similar conduct or events that gave rise to the claims addressed by the injunction issued under paragraph (1); and

(C) pursuant to the plan, is to be paid by a trust described in paragraph (2)(B)(i).

(6) Paragraph (3)(A)(i) does not bar an action taken by or at the direction of an appellate court on appeal of an injunction issued under paragraph (1) or of the order of confirmation that relates to the injunction.

(7) This subsection does not affect the operation of section 1144 or the power of the district court to refer a proceeding under [section 157 of title 28](#) or any reference of a proceeding made prior to the date of the enactment of this subsection.

### **Section 524(h)**

(h) Application to Existing Injunctions.—For purposes of subsection (g)—

(1) subject to paragraph (2), if an injunction of the kind described in subsection (g)(1)(B) was issued before the date of the enactment of this Act, as part of a plan of reorganization confirmed by an order entered before such date, then the injunction shall be considered to meet the requirements of subsection (g)(2)(B) for purposes of subsection (g)(2)(A), and to satisfy subsection (g)(4)(A)(ii), if—

(A) the court determined at the time the plan was confirmed that the plan was fair and equitable in accordance with the requirements of section 1129(b);

(B) as part of the proceedings leading to issuance of such injunction and confirmation of such plan, the court had appointed a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands described in subsection (g)(4)(B) with respect to such plan; and

(C) such legal representative did not object to confirmation of such plan or issuance of such injunction; and

(2) for purposes of paragraph (1), if a trust described in subsection (g)(2)(B)(i) is subject to a court order on the date of the enactment of this Act staying such trust from settling or paying further claims—

(A) the requirements of subsection (g)(2)(B)(ii)(V) shall not apply with respect to such trust until such stay is lifted or dissolved; and

(B) if such trust meets such requirements on the date such stay is lifted or dissolved, such trust shall be considered to have met such requirements continuously from the date of the enactment of this Act.

### **Section 111(b) of The Bankruptcy Reform Act of 1994**

(b) RULE OF CONSTRUCTION.— Nothing in subsection (a), or in the amendments made by [§524(g)-(h)], shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization.

**Section 1123(a)(5) and (b)(6)**

- (a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—
- (1) designate, subject to [section 1122 of this title](#), classes of claims, other than claims of a kind specified in section 507(a)(2), 507(a)(3), or 507(a)(8) of this title, and classes of interests;
  - (2) specify any class of claims or interests that is not impaired under the plan;
  - (3) specify the treatment of any class of claims or interests that is impaired under the plan;
  - (4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;
  - (5) provide adequate means for the plan’s implementation, such as—
    - (A) retention by the debtor of all or any part of the property of the estate;
    - (B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;
    - (C) merger or consolidation of the debtor with one or more persons;
    - (D) sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate;
    - (E) satisfaction or modification of any lien;
    - (F) cancellation or modification of any indenture or similar instrument;
    - (G) curing or waiving of any default;
    - (H) extension of a maturity date or a change in an interest rate or other term of outstanding securities;
    - (I) amendment of the debtor’s charter; or
    - (J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose;
  - (6) provide for the inclusion in the charter of the debtor, if the debtor is a corporation, or of any corporation referred to in paragraph (5)(B) or (5)(C) of this subsection, of a provision prohibiting the issuance of nonvoting equity securities, and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securities with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends;
  - (7) contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee; and
  - (8) in a case in which the debtor is an individual, provide for the payment to creditors under the plan of all or such portion of earnings from personal services performed by the

debtor after the commencement of the case or other future income of the debtor as is necessary for the execution of the plan.

- (b) Subject to subsection (a) of this section, a plan may—
- (1) impair or leave unimpaired any class of claims, secured or unsecured, or of interests;
  - (2) subject to [section 365 of this title](#), provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;
  - (3) provide for—
    - (A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate; or
    - (B) the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest;
  - (4) provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests;
  - (5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; and
  - (6) include any other appropriate provision not inconsistent with the applicable provisions of this title.



## Chapter 3B

# The Outer Limits of Bankruptcy: Third-Party Releases and the “Texas Two-Step”

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**No course materials were submitted  
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## Chapter 4

# Evidentiary Issues in Bankruptcy Cases: Objections and Opportunities

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# Evidentiary Issues in Bankruptcy Cases: Objections and Opportunities

2022 Northwest Bankruptcy Institute

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## 1 HYPOTHETICALS

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### 1.1 HYPOTHETICAL 1 (FRAUD TRANSFER ADVERSARY PROCEEDING)

Daddy Bigbucks is sued by Carey Creditor for breach of contract. On March 1, 2022, a judgment is entered against Daddy Bigbucks in the amount of \$1,000,000. A couple weeks later, on March 15, Daddy Bigbucks gifts his new girlfriend Rachelle Recipient a Lamborghini for her birthday. Following collection efforts by Carey Creditor, Daddy Bigbucks files for Chapter 7 bankruptcy on May 1, 2022.

Tenacious Tommy is appointed as Trustee in Daddy Bigbuck's case and after reviewing the petition, he discovers the gifted Lamborghini. Tommy Trustee initiates an adversary proceeding against Rachelle Recipient to avoid transfer of the vehicle, asserting fraudulent transfer claims under state and federal law. At trial, the parties each seek to admit the following evidence:

#### Tommy Trustee:

1. Trustee's declaration attaching a print out from the Kelley Blue Book and NADA websites stating the value of the Lamborghini at \$150,000.
2. A document showing ending balances from bank statements for each of Daddy's 8 bank accounts, along with corresponding statement and balance dates, over the past 6 months. The underlying statements themselves are not admitted into evidence and total 336 pages.
3. A document showing how much debt was owed across Daddy's 3 credit cards over the past 6 months, as tallied by Tommy Trustee's law clerk based on review of credit card statements, and with notes on insolvency status in red. The credit card statements total 9 pages and were not produced in discovery.

#### Rachelle Recipient:

1. An attorney declaration from Rachelle's counsel Lenny Lawyer, an Italian car enthusiast, attesting to the value of the Lamborghini and opining that because it was goblin green, its fair market value was in fact only \$25,000.

2. Testimony by Rachelle as to the poor condition of vehicle

## **1.2 HYPOTHETICAL 2 (VALUATION DISPUTE – CONTESTED MATTER)**

Zillionaire LLC owns a commercial building that is 50% occupied. The building is encumbered by a first position deed of trust which secures a \$10,000,000 promissory note in favor of Bazooka Bank, Zillionaire's primary creditor.

Zillionaire's anchor tenant has decided to not renew its lease (as employees now prefer to work from home in their PJs). Zillionaire's revenue hasn't recovered from several years of low occupancy. Zillionaire defaults on its loan and Bazooka initiates foreclosure proceedings against building. Before the scheduled sale, Zillionaire files for chapter 11 bankruptcy.

Zillionaire values the building at \$15 million. Bazooka asserts the value of the building is \$8 million and seeks relief from the automatic stay to proceed with foreclosure based on lack of adequate protection. The parties disclose competing valuation experts. The court sets the motion for an evidentiary hearing as a contested matter. At the hearing, each party seeks to admit and present the following evidence:

### **Zillionaire – Debtor**

1. A broker price opinion authored by Bob Broker, opining that the property is worth \$15 million. The BPO relies on Zillionaire's business plan and forecasts as well as general market data. Bob Broker spoke with Zillionaire's CFO, but did not validate the underlying records.
2. Testimony of value from Eddie Entrepreneur, Zillionaire's CEO and majority owner. Eddie has been CEO of Zillionaire for 10 years and authorizes Zillionaire's approval of tenants and execution of leases.
3. Copy of a recent insurance appraisal
4. Print out from the County website showing Tax Assessed value
5. A print out of a Zillow Value Report

### **Bazooka Bank**

6. Testimony by broker Suzie Q, opining that Bob Broker overvalued the building. Suzie Q relies on Maggie Mogul, a local commercial real estate broker with 35 years of experience in reaching this conclusion. Suzie talked to Maggie and reviewed her pricing guide. Maggie has not been disclosed as an expert.

**PLAINTIFF/TRUSTEE'S SUMMARY EXHIBIT 3**  
**DEBTOR CREDIT CARD BALANCES NOVEMBER 2021 - APRIL 2022**

<b>Bank Account</b>	<b>Statement Date</b>	<b>Ending Balance Date</b>	<b>Ending Balance</b>
<b>Wells Fargo – 3995</b>	<b>5/5/2022</b>	<b>4/30/2022</b>	<b>\$20,591.00</b>
Wells Fargo – 3995	4/5/2022	3/31/2022	\$20,100.40
Wells Fargo – 3995	3/5/2022	2/28/2022	\$146,348.29
Wells Fargo – 3995	2/5/2022	1/31/2022	\$160,599.45
Wells Fargo – 3995	1/5/2022	12/31/2021	\$185,644.88
Wells Fargo – 3995	12/5/2021	11/30/2021	\$182,547.65
<b>Bank of America - 4656</b>	<b>5/6/2022</b>	<b>4/30/2022</b>	<b>\$8,827.40</b>
Bank of America - 4656	4/6/2022	3/31/2022	\$8,140.56
Bank of America - 4656	3/6/2022	2/28/2022	\$204,887.61
Bank of America - 4656	2/6/2022	1/31/2022	\$224,839.23
Bank of America - 4656	1/6/2022	12/31/2021	\$259,902.83
Bank of America - 4656	12/6/2021	11/30/2021	\$255,566.71
<b>Chase Bank - 2209</b>	<b>5/8/2022</b>	<b>4/30/2022</b>	<b>\$472.80</b>
Chase Bank - 2209	4/8/2022	3/31/2022	\$80.32
Chase Bank - 2209	3/8/2022	2/28/2022	\$117,078.63
Chase Bank - 2209	2/8/2022	1/31/2022	\$128,479.56
Chase Bank - 2209	1/8/2022	12/31/2021	\$148,515.90
Chase Bank - 2209	12/8/2021	11/30/2021	\$146,038.12
<b>US Bank - 5669</b>	<b>5/5/2022</b>	<b>4/30/2022</b>	<b>\$4,118.20</b>
US Bank - 5669	4/5/2022	3/31/2022	\$4,020.08
US Bank - 5669	3/5/2022	2/28/2022	\$29,269.66
US Bank - 5669	2/5/2022	1/31/2022	\$32,119.89
US Bank - 5669	1/5/2022	12/31/2021	\$37,128.98
US Bank - 5669	12/5/2021	11/30/2021	\$36,509.53
<b>US Bank - 3340</b>	<b>5/5/2022</b>	<b>4/30/2022</b>	<b>\$6,177.30</b>
US Bank - 3340	4/5/2022	3/31/2022	\$6,030.12
US Bank - 3340	3/5/2022	2/28/2022	\$43,904.49
US Bank - 3340	2/5/2022	1/31/2022	\$48,179.84
US Bank - 3340	1/5/2022	12/31/2021	\$55,693.46
US Bank - 3340	12/5/2021	11/30/2021	\$54,764.30
<b>US Bank - 4306</b>	<b>5/5/2022</b>	<b>4/30/2022</b>	<b>\$5,147.75</b>
US Bank - 4306	4/5/2022	3/31/2022	\$5,025.10
US Bank - 4306	3/5/2022	2/28/2022	\$36,587.07
US Bank - 4306	2/5/2022	1/31/2022	\$40,149.86
US Bank - 4306	1/5/2022	12/31/2021	\$46,411.22
US Bank - 4306	12/5/2021	11/30/2021	\$45,636.91
<b>Cathay – 8088</b>	<b>5/7/2022</b>	<b>4/30/2022</b>	<b>\$6,768.30</b>
Cathay – 8088	4/7/2022	3/31/2022	\$6,130.52
Cathay – 8088	3/7/2022	2/28/2022	\$190,252.78
Cathay – 8088	2/7/2022	1/31/2022	\$208,779.29
Cathay – 8088	1/7/2022	12/31/2021	\$241,338.34
Cathay – 8088	12/7/2021	11/30/2021	\$237,311.95
<b>Umpqua - 1628</b>	<b>5/7/2022</b>	<b>4/30/2022</b>	<b>\$7,063.80</b>
Umpqua - 1628	4/7/2022	3/31/2022	\$6,180.72
Umpqua - 1628	3/7/2022	2/28/2022	\$263,426.92
Umpqua - 1628	2/7/2022	1/31/2022	\$289,079.01
Umpqua - 1628	1/7/2022	12/31/2021	\$334,160.78
Umpqua - 1628	12/7/2021	11/30/2021	\$328,585.77

**Debtor's credit cards:**

1. Visa – XXXX XXXX XXXX 2052
2. Mastercard – XXXX XXXX XXXX 4016
3. American Express – XXXX XXXX XXXX 7759

**Total Monthly Credit Card Balances:**

April 2022 - \$105,644.42

**INSOLVENT**

March 2022 - \$89,583.98

**INSOLVENT**

February 2022 - \$22,997.45

**SOLVENT**

January 2022 - \$26,873.57

**SOLVENT**

December 2021 - \$33,414.30

**SOLVENT**

November 2021 - \$23,566.69

**SOLVENT**

## 2 CONTESTED MATTER VS. ADVERSARY PROCEEDING

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### 2.1 RULE 7001. SCOPE OF RULES OF PART VII

An adversary proceeding is governed by the rules of this Part VII. The following are adversary proceedings:

- (1) a proceeding to recover money or property, other than a proceeding to compel the debtor to deliver property to the trustee, or a proceeding under §554(b) or §725 of the Code, Rule 2017, or Rule 6002;
- (2) a proceeding to determine the validity, priority, or extent of a lien or other interest in property, but not a proceeding under Rule 3012 or Rule 4003(d);
- (3) a proceeding to obtain approval under §363(h) for the sale of both the interest of the estate and of a co-owner in property;
- (4) a proceeding to object to or revoke a discharge, other than an objection to discharge under §§727(a)(8), 1 (a)(9), or 1328(f);
- (5) a proceeding to revoke an order of confirmation of a chapter 11, chapter 12, or chapter 13 plan;
- (6) a proceeding to determine the dischargeability of a debt;
- (7) a proceeding to obtain an injunction or other equitable relief, except when a chapter 9, chapter 11, chapter 12, or chapter 13 plan provides for the relief;
- (8) a proceeding to subordinate any allowed claim or interest, except when a chapter 9, chapter 11, chapter 12, or chapter 13 plan provides for subordination;
- (9) a proceeding to obtain a declaratory judgment relating to any of the foregoing; or
- (10) a proceeding to determine a claim or cause of action removed under 28 U.S.C. §1452.

### 2.2 RULE 9014. CONTESTED MATTERS

(a) Motion. In a contested matter not otherwise governed by these rules, relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought. No response is required under this rule unless the court directs otherwise.

(b) Service. The motion shall be served in the manner provided for service of a summons and complaint by Rule 7004 and within the time determined under Rule 9006(d). Any written response to the motion shall be served within the time determined under Rule 9006(d). Any paper served after the motion shall be served in the manner provided by Rule 5(b) F.R.Civ.P.

(c) Application of Part VII Rules. Except as otherwise provided in this rule, and unless the court directs otherwise, the following rules shall apply: 7009, 7017, 7021, 7025, 7026, 7028–7037, 7041, 7042, 7052, 7054–7056, 7064, 7069, and 7071. The following subdivisions of Fed. R. Civ. P. 26, as incorporated by Rule 7026, shall not apply in a contested matter unless the court directs otherwise: 26(a)(1) (mandatory

disclosure), 26(a)(2) (disclosures regarding expert testimony) and 26(a)(3) (additional pre-trial disclosure), and 26(f) (mandatory meeting before scheduling conference/discovery plan). An entity that desires to perpetuate testimony may proceed in the same manner as provided in Rule 7027 for the taking of a deposition before an adversary proceeding. The court may at any stage in a particular matter direct that one or more of the other rules in Part VII shall apply. The court shall give the parties notice of any order issued under this paragraph to afford them a reasonable opportunity to comply with the procedures prescribed by the order.

(d) Testimony of Witnesses. Testimony of witnesses with respect to disputed material factual issues shall be taken in the same manner as testimony in an adversary proceeding.

(e) Attendance of Witnesses. The court shall provide procedures that enable parties to ascertain at a reasonable time before any scheduled hearing whether the hearing will be an evidentiary hearing at which witnesses may testify.

## 3 SOURCES OF EVIDENTIARY RULES

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### 3.1 RULE 9017. EVIDENCE

The **Federal Rules of Evidence** and **Rules 43, 44** and **44.1 F.R.Civ.P.** apply in cases under the Code.

Notes of Advisory Committee on Rules—1983

Sections 251 and 252 of Public Law 95–598, amended Rule 1101 of the Federal Rules of Evidence to provide that the Federal Rules of Evidence apply in bankruptcy courts and to any case or proceeding under the Code. Rules 43, 44 and 44.1 of the F.R.Civ.P., which supplement the Federal Rules of Evidence, are by this rule made applicable to cases under the Code.

Examples of bankruptcy rules containing matters of an evidentiary nature are: **Rule 2011**, evidence of debtor retained in possession; **Rule 3001(f)**, proof of claim constitutes prima facie evidence of the amount and validity of a claim; and **Rule 5007(c)**, sound recording of court proceedings constitutes the record of the proceedings.

### 3.2 RULE 43. TAKING TESTIMONY

(a) In Open Court. At trial, the witnesses' testimony must be taken in open court unless a federal statute, the Federal Rules of Evidence, these rules, or other rules adopted by the Supreme Court provide otherwise. For good cause in compelling circumstances and with appropriate safeguards, the court may permit testimony in open court by contemporaneous transmission from a different location.

(b) Affirmation Instead of an Oath. When these rules require an oath, a solemn affirmation suffices.

(c) Evidence on a Motion. When a motion relies on facts outside the record, the court may hear the matter on affidavits or may hear it wholly or partly on oral testimony or on depositions.

(d) Interpreter. The court may appoint an interpreter of its choosing; fix reasonable compensation to be paid from funds provided by law or by one or more parties; and tax the compensation as costs.

### 3.3 RULE 44. PROVING AN OFFICIAL RECORD

(a) Means of Proving.

(1) *Domestic Record*. Each of the following evidences an official record—or an entry in it—that is otherwise admissible and is kept within the United States, any state, district, or commonwealth, or any territory subject to the administrative or judicial jurisdiction of the United States:

(A) an official publication of the record; or

(B) a copy attested by the officer with legal custody of the record—or by the officer's deputy—and accompanied by a certificate that the officer has custody. The certificate must be made under seal:

(i) by a judge of a court of record in the district or political subdivision where the record is kept; or

(ii) by any public officer with a seal of office and with official duties in the district or political subdivision where the record is kept.

(2) *Foreign Record*.

(A) *In General*. Each of the following evidences a foreign official record—or an entry in it—that is otherwise admissible:

(i) an official publication of the record; or

(ii) the record—or a copy—that is attested by an authorized person and is accompanied either by a final certification of genuineness or by a certification under a treaty or convention to which the United States and the country where the record is located are parties.

(B) *Final Certification of Genuineness*. A final certification must certify the genuineness of the signature and official position of the attester or of any foreign official whose certificate of genuineness relates to the attestation or is in a chain of certificates of genuineness relating to the attestation. A final certification may be made by a secretary of a United States embassy or legation; by a consul general, vice consul, or consular agent of the United States; or by a diplomatic or consular official of the foreign country assigned or accredited to the United States.

(C) *Other Means of Proof*. If all parties have had a reasonable opportunity to investigate a foreign record's authenticity and accuracy, the court may, for good cause, either:

(i) admit an attested copy without final certification; or

(ii) permit the record to be evidenced by an attested summary with or without a final certification.

(b) Lack of a Record. A written statement that a diligent search of designated records revealed no record or entry of a specified tenor is admissible as evidence that the records contain no such record or entry. For domestic records, the statement must be authenticated under Rule 44(a)(1). For foreign records, the statement must comply with (a)(2)(C)(ii).

(c) Other Proof. A party may prove an official record—or an entry or lack of an entry in it—by any other method authorized by law.

### **3.4 RULE 44.1. DETERMINING FOREIGN LAW**

A party who intends to raise an issue about a foreign country's law must give notice by a pleading or other writing. In determining foreign law, the court may consider any relevant material or source, including testimony, whether or not submitted by a party or admissible under the Federal Rules of Evidence. The court's determination must be treated as a ruling on a question of law.

## **4 EXCERPTS FROM THE FEDERAL RULES OF EVIDENCE**

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### **4.1 RULE 201. JUDICIAL NOTICE OF ADJUDICATIVE FACTS**

(a) Scope. This rule governs judicial notice of an adjudicative fact only, not a legislative fact.

(b) Kinds of Facts That May Be Judicially Noticed. The court may judicially notice a fact that is not subject to reasonable dispute because it:

(1) is generally known within the trial court's territorial jurisdiction; or

(2) can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned.

(c) Taking Notice. The court:

(1) may take judicial notice on its own; or

(2) must take judicial notice if a party requests it and the court is supplied with the necessary information.

(d) Timing. The court may take judicial notice at any stage of the proceeding.

(e) Opportunity to Be Heard. On timely request, a party is entitled to be heard on the propriety of taking judicial notice and the nature of the fact to be noticed. If the court takes judicial notice before notifying a party, the party, on request, is still entitled to be heard.

(f) Instructing the Jury. In a civil case, the court must instruct the jury to accept the noticed fact as conclusive. In a criminal case, the court must instruct the jury that it may or may not accept the noticed fact as conclusive.

## **4.2 RULE 701. OPINION TESTIMONY BY LAY WITNESSES**

If a witness is not testifying as an expert, testimony in the form of an opinion is limited to one that is:

- (a) rationally based on the witness's perception;
- (b) helpful to clearly understanding the witness's testimony or to determining a fact in issue; and
- (c) not based on scientific, technical, or other specialized knowledge within the scope of Rule 702.

## **4.3 RULE 702. TESTIMONY BY EXPERT WITNESSES**

A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:

- (a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
- (b) the testimony is based on sufficient facts or data;
- (c) the testimony is the product of reliable principles and methods; and
- (d) the expert has reliably applied the principles and methods to the facts of the case.

## **4.4 RULE 703. BASES OF AN EXPERT**

An expert may base an opinion on facts or data in the case that the expert has been made aware of or personally observed. If experts in the particular field would reasonably rely on those kinds of facts or data in forming an opinion on the subject, they need not be admissible for the opinion to be admitted. But if the facts or data would otherwise be inadmissible, the proponent of the opinion may disclose them to the jury only if their probative value in helping the jury evaluate the opinion substantially outweighs their prejudicial effect.

## **4.5 RULE 901. AUTHENTICATING OR IDENTIFYING EVIDENCE**

(a) In General. To satisfy the requirement of authenticating or identifying an item of evidence, the proponent must produce evidence sufficient to support a finding that the item is what the proponent claims it is.

(b) Examples. The following are examples only — not a complete list — of evidence that satisfies the requirement:

- (1) Testimony of a Witness with Knowledge. Testimony that an item is what it is claimed to be.
- (2) Nonexpert Opinion About Handwriting. A nonexpert's opinion that handwriting is genuine, based on a familiarity with it that was not acquired for the current litigation.
- (3) Comparison by an Expert Witness or the Trier of Fact. A comparison with an authenticated specimen by an expert witness or the trier of fact.

- (4) **Distinctive Characteristics and the Like.** The appearance, contents, substance, internal patterns, or other distinctive characteristics of the item, taken together with all the circumstances.
- (5) **Opinion About a Voice.** An opinion identifying a person’s voice — whether heard firsthand or through mechanical or electronic transmission or recording — based on hearing the voice at any time under circumstances that connect it with the alleged speaker.
- (6) **Evidence About a Telephone Conversation.** For a telephone conversation, evidence that a call was made to the number assigned at the time to:
- (A) a particular person, if circumstances, including self-identification, show that the person answering was the one called; or
  - (B) a particular business, if the call was made to a business and the call related to business reasonably transacted over the telephone.
- (7) **Evidence About Public Records.** Evidence that:
- (A) a document was recorded or filed in a public office as authorized by law; or
  - (B) a purported public record or statement is from the office where items of this kind are kept.
- (8) **Evidence About Ancient Documents or Data Compilations.** For a document or data compilation, evidence that it:
- (A) is in a condition that creates no suspicion about its authenticity;
  - (B) was in a place where, if authentic, it would likely be; and
  - (C) is at least 20 years old when offered.
- (9) **Evidence About a Process or System.** Evidence describing a process or system and showing that it produces an accurate result.
- (10) **Methods Provided by a Statute or Rule.** Any method of authentication or identification allowed by a federal statute or a rule prescribed by the Supreme Court.

#### **4.6 RULE 902. EVIDENCE THAT IS SELF-AUTHENTICATING**

The following items of evidence are self-authenticating; they require no extrinsic evidence of authenticity in order to be admitted:

**(1) *Domestic Public Documents That Are Sealed and Signed.*** A document that bears:

- (A)** a seal purporting to be that of the United States; any state, district, commonwealth, territory, or insular possession of the United States; the former Panama Canal Zone; the Trust Territory of the Pacific Islands; a political subdivision of any of these entities; or a department, agency, or officer of any entity named above; and
- (B)** a signature purporting to be an execution or attestation.

**(2) Domestic Public Documents That Are Not Sealed but Are Signed and Certified.** A document that bears no seal if:

- (A) it bears the signature of an officer or employee of an entity named in [Rule 902\(1\)\(A\)](#); and
- (B) another public officer who has a seal and official duties within that same entity certifies under seal — or its equivalent — that the signer has the official capacity and that the signature is genuine.

**(3) Foreign Public Documents.** A document that purports to be signed or attested by a person who is authorized by a foreign country's law to do so. The document must be accompanied by a final certification that certifies the genuineness of the signature and official position of the signer or attester — or of any foreign official whose certificate of genuineness relates to the signature or attestation or is in a chain of certificates of genuineness relating to the signature or attestation. The certification may be made by a secretary of a United States embassy or legation; by a consul general, vice consul, or consular agent of the United States; or by a diplomatic or consular official of the foreign country assigned or accredited to the United States. If all parties have been given a reasonable opportunity to investigate the document's authenticity and accuracy, the court may, for good cause, either:

- (A) order that it be treated as presumptively authentic without final certification; or
- (B) allow it to be evidenced by an attested summary with or without final certification.

**(4) Certified Copies of Public Records.** A copy of an official record — or a copy of a document that was recorded or filed in a public office as authorized by law — if the copy is certified as correct by:

- (A) the custodian or another person authorized to make the certification; or
- (B) a certificate that complies with Rule 902(1), (2), or (3), a federal statute, or a rule prescribed by the Supreme Court.

**(5) Official Publications.** A book, pamphlet, or other publication purporting to be issued by a public authority.

**(6) Newspapers and Periodicals.** Printed material purporting to be a newspaper or periodical.

**(7) Trade Inscriptions and the Like.** An inscription, sign, tag, or label purporting to have been affixed in the course of business and indicating origin, ownership, or control.

**(8) Acknowledged Documents.** A document accompanied by a certificate of acknowledgment that is lawfully executed by a notary public or another officer who is authorized to take acknowledgments.

**(9) Commercial Paper and Related Documents.** Commercial paper, a signature on it, and related documents, to the extent allowed by general commercial law.

**(10) Presumptions Under a Federal Statute.** A signature, document, or anything else that a federal statute declares to be presumptively or prima facie genuine or authentic.

**(11) Certified Domestic Records of a Regularly Conducted Activity.** The original or a copy of a domestic record that meets the requirements of Rule 803(6)(A)-(C), as shown by a certification

of the custodian or another qualified person that complies with a federal statute or a rule prescribed by the Supreme Court. Before the trial or hearing, the proponent must give an adverse party reasonable written notice of the intent to offer the record — and must make the record and certification available for inspection — so that the party has a fair opportunity to challenge them.

**(12) Certified Foreign Records of a Regularly Conducted Activity.** In a civil case, the original or a copy of a foreign record that meets the requirements of Rule 902(11), modified as follows: the certification, rather than complying with a federal statute or Supreme Court rule, must be signed in a manner that, if falsely made, would subject the maker to a criminal penalty in the country where the certification is signed. The proponent must also meet the notice requirements of Rule 902(11).

**(13) Certified Records Generated by an Electronic Process or System.** A record generated by an electronic process or system that produces an accurate result, as shown by a certification of a qualified person that complies with the certification requirements of Rule 902(11) or (12). The proponent must also meet the notice requirements of Rule 902(11).

**(14) Certified Data Copied from an Electronic Device, Storage Medium, or File.** Data copied from an electronic device, storage medium, or file, if authenticated by a process of digital identification, as shown by a certification of a qualified person that complies with the certification requirements of Rule (902(11) or (12). The proponent also must meet the notice requirements of Rule 902 (11).

#### **4.7 RULE 1002. REQUIREMENT OF THE ORIGINAL**

An original writing, recording, or photograph is required in order to prove its content unless these rules or a federal statute provides otherwise.

#### **4.8 RULE 1003. ADMISSIBILITY OF DUPLICATES**

A duplicate is admissible to the same extent as the original unless a genuine question is raised about the original's authenticity or the circumstances make it unfair to admit the duplicate.

#### **4.9 RULE 1005. COPIES OF PUBLIC RECORDS TO PROVE CONTENT**

The proponent may use a copy to prove the content of an official record — or of a document that was recorded or filed in a public office as authorized by law — if these conditions are met: the record or document is otherwise admissible; and the copy is certified as correct in accordance with Rule 902(4) or is testified to be correct by a witness who has compared it with the original. If no such copy can be obtained by reasonable diligence, then the proponent may use other evidence to prove the content.

#### **4.10 RULE 1006. SUMMARIES TO PROVE CONTENT**

The proponent may use a summary, chart, or calculation to prove the content of voluminous writings, recordings, or photographs that cannot be conveniently examined in court. The proponent must make the originals or duplicates available for examination or copying, or both, by other parties at a reasonable time and place. And the court may order the proponent to produce them in court.

## **Chapter 5**

# **Presentation Slides: Ethics 101: Recent Lessons for Bankruptcy Lawyers and Judges**

**PROFESSOR LAURIE LEVENSON**

Loyola Law School  
Los Angeles, California



# NW BANKRUPTCY INSTITUTE



Ethics 101: Recent Lessons for  
Bankruptcy Lawyers and Judges

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## Hypo #1

### “Trying Your Case in the Press”

- Big Pharma Co. goes into bankruptcy after selling a dangerous drug. Victims who lost loved ones from use of the drug object to a bankruptcy settlement. They ask their lawyer to draft statements they can read to the press challenging the court’s decision.
- Is it proper for counsel to prepare the statements for the press?



## Model Rule 3.6

- (a) Lawyer shall not make an “extrajudicial statement that the lawyer knows or reasonably should know will ... have a substantial likelihood of materially prejudicing an adjudicative proceeding in the matter.”



## Hypo #2

### “Play by the Rules”

- Your client is being deposed on zoom. While he is being asked questions, you try to help by texting him necessary information for his answers.
- Is this a problem?



## Duties to Court and Opposing Counsel

### ➤ Rule 3.4(e): Fairness to Opposing Party and Counsel

- Lawyer shall not knowingly disobey an obligation under the rules of a tribunal.



- ### ➤ Bar on coaching witnesses (Florida Bar v. James, Derek Vashon, No. SC 20-128 (Nov. 18, 2021))

## Hypo #3 “Beware of Clients”

- ### ➤ A client approaches you to handle a hotly contested Ch. 11 case involving, among other issues, ownership of a house valued at \$10 million. You learn that your client’s first lawyer moved to withdraw shortly after the client had him introduce a purported deed for the home. What should you do?

- A. Proceed with the representation but raise your retainer;
- B. Grill your client about why he changed lawyers;
- C. Rely on your client’s representations as to the value of the home and validity of the deed;
- D. None of the above



## Rule 3.3. Candor Toward Tribunal

a) A lawyer shall not knowingly:

(1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer; or

(3) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

## Comment [10]

- [10] Having offered material evidence in the belief that it was true, a lawyer may subsequently come to know that the evidence is false. Or, a lawyer may be surprised when the lawyer's client, or another witness called by the lawyer, offers testimony the lawyer knows to be false.... In such situations ..., the lawyer must take reasonable remedial measures. [T]he advocate's proper course is to remonstrate with the client confidentially, advise the client of the lawyer's duty of candor to the tribunal and seek the client's cooperation with respect to the withdrawal or correction of the false statements or evidence. If that fails, the advocate must take further remedial action. If withdrawal from the representation is not permitted or will not undo the effect of the false evidence, the advocate must make such disclosure to the tribunal as is reasonably necessary to remedy the situation, even if doing so requires the lawyer to reveal information that otherwise would be protected by Rule 1.6.

## 18 USC § 157 Bankruptcy Fraud

- A person who, having devised or intending to devise a scheme or artifice to defraud ...
- (3) makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under title 11, at any time before or after filing of the petition ... shall be ... imprisoned not more than 5 years.

## Evaluating Prospective Clients

- Rule 1.16: Lawyer shall not represent a client if the representation will result in a violation of the rules or professional conduct or other law.
- Rule 2.1: Lawyer's duty to render "candid advice"



## Hypo #4 “Staying Civil”

- You are hired to handle a bankruptcy action where family members are demanding scorched earth tactics against other family members. Your client tells you to “do everything you can to make my sibling’s life a living hell.”
- What should you do?

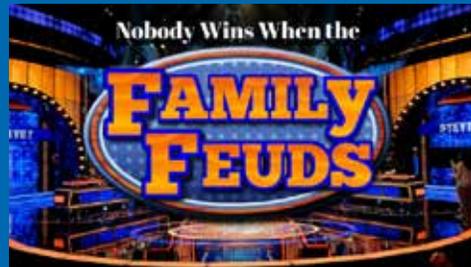


## Rule 2.1 Lawyer as Advisor

- In representing a client, a lawyer shall exercise independent judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client’s situation.

## Comment [4]

- Matters that go beyond strictly legal questions may also be in the domain of another profession. Family matters can involve problems within the professional competence of psychiatry, clinical psychology or social work.



## Rule 1.16 Comment [7]

- The lawyer may also withdraw where the client insists on taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement.



## Hypo #5

### “Too Friendly for Your Own Good?”

- Judge Klein and Lucy Flevinson once worked together at a firm and occasionally see each other at court receptions and social events.
- Which of the following is proper?
  - A. Flevinson to tell her client that they are in good shape because Judge Klein likes and respects Flevinson;
  - B. Flevinson to invite Judge Klein to speak at a brown-bag lunch at Flevinson’s firm;
  - C. Flevinson sending a congratulatory card to Judge Klein’s child who just graduated college;
  - D. None of the above.



## Rule 3.5

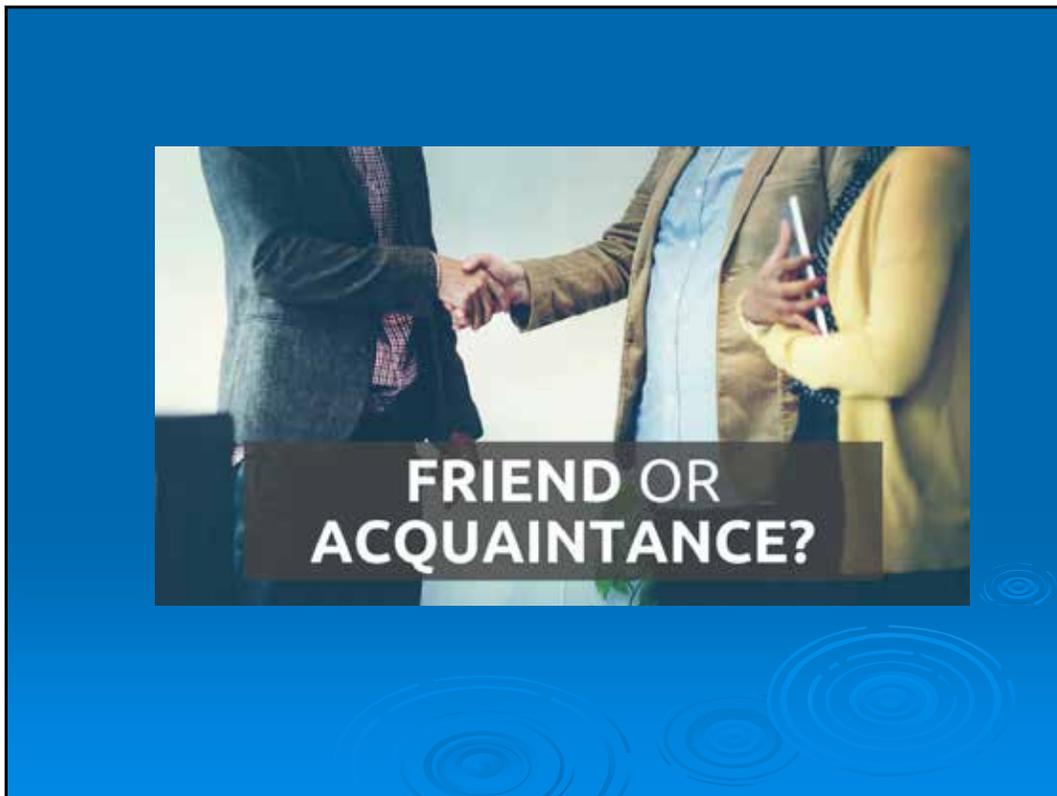
- A lawyer shall not:
  - (a) Seek to influence a judge, juror, prospective juror or other official by means prohibited by law.

## Code of Judicial Conduct

- Canon 2(B): A judge should not allow family, social, political financial, or other relationships to influence judicial conduct or judgment.

## ABA FORMAL OPINION 488

- Judges' social or close personal relationship with lawyers or parties are grounds for disqualification or closure
- Requirement to recuse if judge's impartiality may be "reasonably questioned"



## Hypo #6 “What a Bogus Ruling!”

- Feris is furious that the court ruled against her client. She tells the client that there was “no more I could do because the judge obviously didn’t read our papers and just ruled from the hip for the other side.”
- Are there any ethical problems with this comment?



## Rule 8.2

- “A lawyer shall not make a statement that the lawyer knows to be false or with reckless disregard as to its truth or falsity concerning the qualifications or integrity of a judge.”

## Hypo #7 “Feedback, Please”

- You just tried your first case in bankruptcy court and you want to get feedback from the judge about how you did.
- Can the judge provide that feedback?

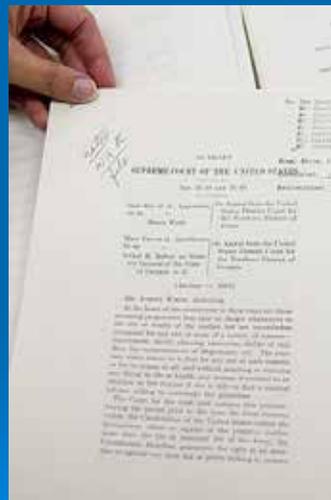


## Draft Formal Op. 2021-018

- Feedback allowed if:
  - Not ex parte communications
  - Doesn't create an appearance of favor or bias
  - Does not suggest that party is in a special position to influence the court
  - Court does not coach party by advising on tactics or strategies, or by giving legal advice

## Hypo #8 “Leaky Chambers”

- You are handling a sensitive matter in Judge A's court. You receive an anonymous letter that seems to have a draft of the court's decision that has not been issued yet.
- What do you do?



## Options

- A. Nothing
- B. Don't read the opinion and return it to the court
- C. Evaluate the opinion to see if there is anything more you should be doing for your client
- D. Notify the court

## Rule 8.4

- Lawyer may not knowingly assist judicial officer (or staff?) in conduct that is in violation of applicable rules of judicial conduct or other law.

## Hypo #9

### Dinner Conversation

- You attend the annual Bankruptcy Bar dinner and a local bankruptcy judge is at your table.
- Are there any topics off-limits while the judge is at the table?



## Rule 8.3(b)

- No ex parte communications with the court
- This includes at social or bar events

## Hypo #10 “It’s Only a Small Fib”

- The court clerk calls you to schedule a hearing. You know you are in a golf tournament that day, but tell the court that you have a scheduled medical procedure.



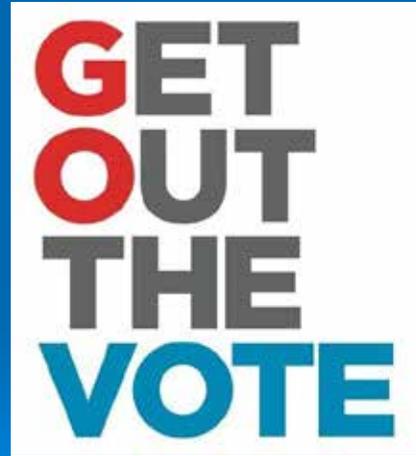
- Does this violate any rule?

## Rule 3.3

- Requires candor toward tribunal
- No false statement of fact or law
- Not limited to representations in pleadings or during court arguments

## Hypo #11 Off-Limits

- You know that a judge feels very strongly about a candidate, so you invite the judge to a rally to get out the vote.
- Is this a problem?



## Canon 5

- A judge should not:
  - Hold any office in a political organization
  - Make speeches for or endorse a candidate
  - Solicit funds for a political organization
  - “A judge should not engage in any other political activity.” (Canon 5(C))

## Hypo #12

### Beware of the Internet

- In your brief, you cite to various sites on the Internet that address issues in your case. Are there any ethical concerns in doing so?



## Rule 3.3. Candor Toward Tribunal

- a) A lawyer shall not knowingly:
  - (1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer.

## How much of the information on Internet is False?

- People, businesses, content can be fake
- Estimate that less than 60% of web traffic is by people; other is by bots masquerading as people
- Researching legal issues on Google is not good research

**THANK YOU**

# Chapter 6

## Ninth Circuit Case Review

### THE HONORABLE WHITMAN HOLT

U.S. Bankruptcy Court, Eastern District of Washington  
Yakima, Washington

### MICHAEL ROGERS

U.S. Bankruptcy Court, Western District of Washington  
Tacoma, Washington

### CATHERINE DEVLIN

U.S. Bankruptcy Court, District of Oregon  
Portland, Oregon

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***Harrington v. Mayer (In re Mayer), 28 F.4th 67 (9th Cir. March 8, 2022)***

**Issue:** When a motion for relief from the automatic stay is denied without prejudice, can it be a final appealable order?

**Holding:** Yes when the record makes clear that the bankruptcy court “unreservedly denied relief.”

**Background:** The case arose from denial of a motion for relief from the automatic stay to litigate state law claims in state court.

The debtor and creditor were former business partners litigating in Massachusetts state court for seven years claims and counterclaims related to breach of fiduciary duty and fraudulent misrepresentation. One week before the jury trial was set to begin in Massachusetts, the defendant filed a chapter 7 petition in California.

The creditor filed a \$2 million claim in bankruptcy court, a complaint to bar discharge of the debt, and a companion motion to modify the automatic stay. The creditor reasoned that the Massachusetts court was familiar with the issues and could resolve all questions about the validity of the claim and facts relating to dischargeability of the claim.

The bankruptcy court ultimately denied the motion without prejudice. Then, the District Court denied leave to appeal the order, deeming it interlocutory. The creditor appealed to the Ninth Circuit.

**Analysis:** The Ninth Circuit addressed an issue left unanswered by the Supreme Court in *Ritzen Group, Inc. v. Jackson Masonry, LLC*, 140 S. Ct. 582 (2020): whether an order denying relief from the automatic stay without prejudice could be a final appealable order. In *Ritzen*, the Supreme Court held that an order denying a relief from stay motion was final and appealable when it “conclusively resolve[d] the movant’s entitlement to the requested relief.” *Id.* at 591. The creditor in *Ritzen* did not appeal the order denying relief from stay to pursue its claims in state court until after the adversary proceeding in the bankruptcy court had been fully litigated. In *Ritzen*, the Supreme Court noted that an order denying relief from the automatic stay is a final appealable order when it “unreservedly grants or denies relief.” *Id.* at 586. However, the Supreme Court specifically did not decide “whether finality would attach to an order denying stay relief if the bankruptcy court enters it ‘without prejudice’ because further developments might change the stay calculus.” *Id.* at 592 n.4.

In *Mayer*, the record was clear that the bankruptcy court intended to hold a trial on the issues and would not be revisiting the issue of whether to send the parties to state court. Instead, the court indicated it would be “willing to consider stay relief if sought for a different purpose, but not for the purpose of resolving the creditor’s state claims against the debtor.” Thus, while nominally denying without prejudice, the bankruptcy court had unreservedly denied relief on the issue being appealed, making it a final appealable order.

In a concurrent unpublished opinion, the Ninth Circuit affirmed the bankruptcy court's denial of relief. Ironically, Judge Tashima, who authored the published opinion, dissented, because there were non-debtor defendants and Judge Tashima noted that judicial economy would have been served by litigating all claims in state court. Further, the Massachusetts state court would not allow the consolidated case to be tried separately. Therefore, the creditor could not proceed against the non-debtor defendants until the stay was lifted.

**Takeaway:** Unless the order denying relief from stay motion without prejudice or some other part of the record clearly indicates that the issue on appeal will not be revisited by the bankruptcy court, the order may not be final. A practice pointer may be to ask the bankruptcy judge if and in what context the court would revisit the issue if denial will be “without prejudice.”

***Milkovich v. United States*, 28 F.4th 1 (9th Cir. Mar. 2, 2022)**

**Issue:** In a short sale after discharge and the trustee abandons the homestead, are debtors entitled to a mortgage interest deduction for amounts that they did not actually pay in cash?

**Holding:** Following a short sale of a debtor's home, a debtor can claim a tax deduction for interest reported by the mortgage holder if the mortgage was valid *ab initio*.

**Background:** Plaintiffs owned a home in Washington with a \$745,000 mortgage. After the housing market collapsed, Plaintiffs stopped making the mortgage payments. In 2010, Plaintiffs filed a chapter 7 petition and scheduled the home as having a value of \$600,000.

Finding no value to creditors, the trustee abandoned the estate's interest in the home and filed a report of no distribution. Plaintiffs received a discharge in April 2010 thereby changing their mortgage from “recourse” to “nonrecourse”.

In 2011, CitiMortgage agreed to a short sale, from which CitiMortgage received \$522,000. CitiMortgage credited approximately \$115,000 to interest and the remainder to principal. CitiMortgage sent Plaintiffs an IRS Form 1098, which reported payment of \$115,000 in mortgage interest and Plaintiffs deducted that amount on their tax return.

The IRS disallowed the deduction and assessed an additional tax. After a failed attempt to have the IRS reconsider the disallowance, Plaintiffs appealed. The IRS appeals office upheld the disallowance, citing IRC § 265 and Treas. Reg. § 1.265-1, which “prohibit the deduction of expenses related to tax-exempt income.” Plaintiffs paid the tax assessed and filed a claim for refund.

After six months of waiting for the IRS to respond, Plaintiffs filed their action in the district court. The IRS filed a motion to dismiss. The district court granted the motion without leave to amend but not on the ground that the IRS proposed. Instead, the district court extended *Estate of Franklin v. Commissioner*, 544 F.2d 1045 (9th Cir. 1976), which

disallowed interest deductions in connection with debt-financed transactions that lacked economic substance. Plaintiffs appealed.

**Analysis:** The Ninth Circuit, in a divided panel, reversed the district court and held that the Plaintiffs were entitled to a refund of the additional tax they paid. Writing for the majority, Judge Collins first found that the district court erred by extending *Franklin* to short sales involving valid mortgages.

In *Franklin*, the court concluded that a partnership's purchase of a motel for an inflated price financed by a nonrecourse loan lacked any economic substance and did not give rise to a "genuine indebtedness," and therefore could not support an interest deduction. The court disallowed the interest deduction and held that the transaction could not be treated as a bona fide sale *ab initio*. The court went on to note that its holding was limited to "substantially similar transactions."

The panel found that the transaction in this case was not a substantially similar to the transaction in *Franklin*. Here, the Plaintiffs' mortgage loan was valid *ab initio*, because the consideration paid for the home was fair market value and the indebtedness for the purchase was legitimate. Quoting *Franklin*, Judge Collins wrote that the fact that bankruptcy turned the debt into a nonrecourse obligation "does not deprive the debt of its character as a bona fide debt obligation able to support an interest deduction." *Franklin*, 544 F.2d at 1049.

Next, the panel rejected the IRS's arguments under IRC § 265 and concluded that the "Plaintiffs' bankruptcy discharge, which converted the mortgage from recourse to nonrecourse . . . had no effect on the otherwise applicable tax treatment of the later short sale." The panel ultimately applied "the normal rules that govern short sales concerning nonrecourse debt" and concluded that the Plaintiffs were entitled to deduct the interest CitiMortgage received from the short sale.

Judge Richard G. Stearns from the District of Massachusetts, sitting by designation, dissented. Judge Stearns took issue with the majority's opinion stating that it was "based on a fictional factual premise." Judge Stearns stated that it is "simply not the case" that the Plaintiffs had paid the mortgage interest and therefore, they could not claim a deduction.

**Takeaway:** Debtors can claim a tax deduction for the portion of a short sale's proceeds allocated to interest.

***Hutchinson v. IRS (In re Hutchinson)*, 15 F.4th 1229 (9th Cir. Dec. 23, 2021)**

**Issues:** Whether a debtor can avoid a tax-penalty lien under § 522(h)? Whether a debtor can preserve, for their own benefit, the portion of a tax lien that is avoided by the trustee?

**Holding:** The Ninth Circuit affirmed the BAP's decision affirming the bankruptcy court's dismissal of the chapter 7 debtors' adversary complaint concerning tax liens asserted by the IRS. The court held that (1) a debtor may not avoid a tax lien under § 522(h); and (2)

a debtor cannot preserve for their own benefit the portion of a tax lien that is avoided by the trustee.

**Background:** Prior to filing for bankruptcy, Leonard and Sonya Hutchinson (“Plaintiffs”) owned a homestead in California. The IRS recorded liens on the homestead to secure a claim for tax penalties for \$162,000.

After filing their chapter 7 case, Plaintiffs filed an adversary proceeding against the IRS and the chapter 7 trustee, seeking: 1) to avoid the liens under § 522(h); and 2) to preserve the property for their own benefit—rather than for the benefit of the estate—to the extent of their \$100,000 state homestead exemption.

Plaintiffs first argued that a tax-penalty lien is the type of lien described in § 726(a)(4) that a trustee can avoid pursuant to § 724(a). Because the trustee by that time had not moved to avoid the lien, the debtor alleged that he could avoid the lien under § 522(h).

Plaintiffs next argued that preservation of the avoided lien for the benefit of the estate is overridden by § 522(i)(2), which says that a transfer avoided under § 724(a) “may be preserved for the benefit of the debtor to the extent the debtor may exempt such property . . .”

The trustee answered and filed a cross claim, asserting his right to avoid the lien and preserve the lien for the estate. The IRS agreed that the trustee could avoid and preserve the lien to the extent it secured penalties under § 724(a) and the bankruptcy court entered a stipulated order. The IRS filed a motion to dismiss the debtor’s complaint. The bankruptcy court granted the IRS’ motion to dismiss. Plaintiffs appealed and the BAP affirmed.

**Analysis:** In this highly-technical decision, the Ninth Circuit analyzed a debtor’s ability to avoid liens under § 522(h). In relevant part, § 522(h) provides that a debtor can avoid a transfer—including a lien—if (1) the transfer is avoidable by the trustee under § 724(a); (2) the trustee does not attempt to avoid the transfer; and (3) the debtor could have exempted the property under § 522(g)(1) if the trustee had avoided the transfer.

The court explained that the third requirement has several components—one of which is that the debtor could have exempted the property under § 522(b) if it had not been transferred. The Plaintiffs argued that they satisfied this requirement because § 522(b) allows them to exempt their interest in their principal residence up to the extent of their \$100,000 homestead exemption.

The Ninth Circuit held that Plaintiffs’ first argument failed for two reasons.

First, § 522(c)(2)(B) prevents a debtor from avoiding federal tax liens on his exempt property even though it is avoidable by a trustee under § 724(a). The court cited *In re DeMarah* in which the Ninth Circuit held that a debtor may not use § 522(h) to “avoid the lien for his tax penalties.” *In re DeMarah*, 62 F.3d 1248, 1250 (9th Cir. 1995). In *DeMarah*, the Ninth Circuit concluded that it was logical for Congress to allow a trustee to avoid a

lien for the benefit of unsecured creditors but not to benefit a debtor who had incurred tax penalties. *Id.* at 1252. Given the binding precedent in *DeMarah*, the court determined that Plaintiffs could not invoke § 522(h) to avoid a properly filed tax lien, even if that lien would be avoidable by the trustee under § 724(a).

Second, a debtor may only avoid a transfer under § 522(h) if the trustee has not attempted to avoid the transfer, and in this case the trustee avoided the lien by stipulation with the IRS. Thus, even absent the binding precedent in *In re DeMarah*, the Plaintiffs would not have been able to use § 522(h) to avoid the tax liens.

Finally, the Ninth Circuit held that the Plaintiffs' second argument failed because under *DeMarah*, "[Section 522(i)(2)] is equally subordinate to § 522(c)(2)(B)'s bright-line rule that debtors lack 'the right to remove tax liens from their otherwise exempt property.'"

**Takeaway:** On a homestead, a trustee can avoid a tax-penalty lien for the benefit of the estate, but a debtor cannot avoid and preserve the same lien for the debtor's benefit.

Section 522(c)(2) clearly states that exempt property is subject to tax liens. It would be contradictory to this provision to find that a tax lien avoided by the trustee would be preserved for the debtor's benefit by claiming an exemption pursuant to § 522(g).

***Stevens v. Whitmore (In re Stevens), 15 F.4th 1214 (9th Cir. Oct. 19, 2021)***

**Issue:** Is an asset automatically abandoned if it is listed in the Statement of Financial Affairs, but not in the Schedules among a debtor's assets?

**Holding:** No, an asset must be listed in the debtor's Schedules, or it will not be automatically abandoned.

**Background:** This case arose because the debtors listed a potential lawsuit in their Statement of Financial Affairs and had discussed it with the Chapter 7 trustee but failed to list it as asset in their schedules, and therefore it was not automatically abandoned when the case was closed. The Chapter 7 trustee moved to reopen the case and filed a motion to approve a settlement of the debtors' pending lawsuit. The bankruptcy court determined that the claim had not been abandoned and approved the settlement.

The debtors were a couple and had begun a lawsuit against their mortgage servicer before filing their chapter 7 petition regarding a conflict over their mortgage and efforts to refinance it. Not included in the opinion, but discussed in Bill Rochelle's Daily Wire, the bankruptcy docket revealed that the trustee had decided not to pursue the lawsuit given the cost of prosecution and the uncertainty of a favorable result.

The trustee issued a no-asset report and certified that the estate was fully administered. The court discharged the trustee and closed the case.

The debtors continued to pursue the litigation against their mortgage servicer. The mortgage servicer approached the trustee prior to a hearing in state court on summary

judgment and offered to settle the case. The trustee accepted on behalf of the estate, moved to reopen the case, and the bankruptcy court approved the settlement.

**Analysis:** This was a case of first impression for the Ninth Circuit and resolved a split between lower courts. The plain language of § 554(c) and 521(a)(1) dictated the outcome of this appeal. In bankruptcy, abandonment is a term of art with special meaning. Unless property is abandoned, it continues to belong to the bankruptcy estate and does not revert to the debtors.

Section 554(c) provides that an asset that is not administered is “abandoned to the debtor” if it was “scheduled under § 521(a)(1).” Section 521(a)(1) mandates that debtors file several documents, including the schedules at issue here. The Code does not define schedule, and when words are not defined in the statute, they are given their plain and ordinary meaning. As applied in this case, the dictionary meaning of the word “scheduled” as used in § 554(c) means “to include something on a literal schedule.” The court in turn, must give schedule, a noun, and scheduled, a verb, as used in the Code, similar meanings—scheduled means included on a schedule. Therefore, listing the lawsuit on the Statement of Financial Affairs would not suffice to schedule it within the meaning of § 554(c).

The Federal Rules of Bankruptcy Procedure further support this analysis because the Rules “routinely distinguish between the bankruptcy petition itself, bankruptcy schedules, the SOFA, and other documents.” Further, the court rejected the debtors’ request to follow pre-Code law that the property was abandoned if the trustee knew about it. The Ninth Circuit concluded that it could not disregard the plain language of the Code.

**Takeaway:** All assets must be scheduled, even if they are listed in the Statement of Financial Affairs, or otherwise disclosed to the trustee. The Ninth Circuit panel in this case was notably resistant to “equitable” or practical arguments that are at odds with the plain text of the Bankruptcy Code.

***In re Nichols, 10 F.4th 956 (9th Cir. Sept. 1, 2021)***

**Issue(s):** Whether a debtor has an absolute right to dismiss a chapter 13 case under 11 U.S.C. § 1307(b)?

**Holding:** The Ninth Circuit reversed the BAP, holding that a debtors’ right to dismiss is absolute, subject to the single exception noted expressly in the statute itself.

**Background:** Chapter 13 debtors, Mr. and Mrs. Nichols, filed bankruptcy following litigation stemming from a restitution award from their son’s bank fraud. For 17 months after filing, the debtors did not take any steps toward Bankruptcy Code compliance or confirmation. The debtors stated their delay was due to multiple federal criminal charges, including bank fraud, against Mr. Nichols and because their bankruptcy and criminal counsel advised them so.

Nine months into their bankruptcy case, creditors sought conversion to chapter 7 under § 1307(c) and (e) for undue delay, ineligibility, and bad faith conduct. The debtors opposed conversion and even requested the bankruptcy court stay all bankruptcy proceedings pending the outcome of their criminal proceedings. The bankruptcy court denied the stay and conditionally granted the conversion motion making these findings: (1) unreasonable delay as cause for conversion under § 1307(c); (2) conversion was in the best interest of creditors and was required under § 1307(e) for the debtors' failure to file tax returns; (3) giving the debtors 30 days to submit tax returns and a stipulated order of confirmation to avoid conversion; and, (4) allowing the trustee to upload a conversion order if the debtors failed their tasks. The debtors appealed the stay denial to the district court. While that appeal was pending, the debtors filed a motion to dismiss their chapter 13 case "as a matter of precaution, to prevent any potential claim of waiver of the right to dismiss." The creditors opposed the dismissal motion urging conversion because of the debtors' bad faith conduct and that dismissal would harm the creditors.

The bankruptcy court held a hearing on the conversion motion and dismissal motion. On the hearing date, the debtors still had not complied with any provision in the bankruptcy court's previous conditional conversion order. The bankruptcy court denied the dismissal motion and granted the conversion motion. The debtors appealed.

On appeal, the debtors contended that *In re Rosson*, 545 F.3d 764 (9th Cir. 2008), no longer controls and the debtors have an absolute right to dismiss under § 1307. The debtors argued that the plain text of § 1307(b) gives them an absolute right to dismiss and that *Rosson* is inconsistent with *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007), and *Law v. Siegel*, 571 U.S. 415 (2014). The BAP affirmed the bankruptcy court and the debtors appealed.

**Analysis:** The Ninth Circuit considered whether debtors in a Chapter 13 bankruptcy have the right to dismiss their case, regardless of the bankruptcy court's determination that they engaged in an abuse of the bankruptcy process. The court joined the Second and Sixth Circuits, concluding that § 1307(b)'s text confers upon the debtor an absolute right to dismiss a Chapter 13 bankruptcy case, subject to the single exception noted expressly in the statute itself. Citing *In re Smith*, 999 F.3d 452 (6th Cir. 2021), the court explained that because chapter 13 serves as an entirely voluntary alternative to chapter 7, interpreting § 1307(b) as conferring an absolute dismissal right is consistent with the Code's narrow allowance for involuntary bankruptcy proceedings.

The court held that *In re Rosson*, which held there was an implied exception to § 1307(b) where the debtor had engaged in bad faith or abuse of the bankruptcy process, was effectively overruled by *Law v. Siegel*, 571 U.S. 415 (2014), which held that a bankruptcy court may not use its equitable powers under 11 U.S.C. § 105 to contravene express provisions of the Bankruptcy Code.

Immediately before reversing the BAP and remanding to the bankruptcy court, Judge O'Scannlain opined that the Bankruptcy Code provides “ample alternative tools for bankruptcy courts to address debtor misconduct.”

**Takeaway:** *Rossen* is no longer binding precedent in this circuit and debtors have an absolute right to dismiss a case under § 1307(b).

This case, along with *In re Smith* and other cases that have applied *Siegel* outside of the exemption context, appear to show an ongoing trend in favor of limiting § 105(a) relief when other Code sections arguably control. Once again, a Ninth Circuit panel is very resistant to “equitable” arguments that are at odds with the statutory text.

This case illustrates how *Miller v. Gammie*, 335 F.3d 889 (9th Cir. 2003) (en banc), creates a relatively loose and flexible standard for a three-judge circuit panel (and a trial court) to determine that a prior three-judge panel opinion has effectively been overruled by a subsequent state or federal Supreme Court opinion. This is a lower standard than in some other circuits.

***Bank of New York Mellon v. Enchantment Sunset Bay Condo. Ass'n.*, 2 F.4th 1229 (9th Cir. June 25, 2021)**

**Issue:** Does a creditor have standing outside of bankruptcy court to assert that an action is void as a consequence of a violation of the automatic stay?

**Holding:** In a 2-1 opinion, the Ninth Circuit Court of Appeals (“Ninth Circuit”) reversed the district court’s grant of summary judgment and held that a mortgagee had standing under a Nevada quiet title statute to invalidate a condominium association’s foreclosure sale on grounds that the sale occurred in violation of the automatic stay.

**Background:** In 2005, Harold Hill purchased property (“Property”), located in the Enchantment at Sunset Bay Condominium Association (“HOA”), and subject to the HOA’s Declaration of Covenants, Conditions and Restrictions. Hill purchased the Property with a loan that was assigned to the Bank of New York Mellon (“Bank”), as the first deed of trust lienholder. Hill defaulted on his payments to the HOA in January 2014, and the HOA recorded a Notice of Delinquent Assessment Lien. Hill filed for chapter 13 bankruptcy in April 2014 and stated in his Plan that he was surrendering the Property to the Bank and the HOA. While the bankruptcy was pending, the HOA recorded a Notice of Foreclosure Sale on July 15, 2014, and sold the Property several weeks later to 732 Hardy Way Trust (“Trust”) for \$6,072.29 at a nonjudicial foreclosure sale.

The Bank initiated a diversity action in U.S. District Court for the District of Nevada (“District Court”) against the HOA and Trust seeking to quiet title and for a declaratory judgment that the foreclosure sale violated the automatic stay and was therefore void and did not extinguish the Bank’s deed of trust.

The Bank and the Trust each moved for summary judgment. The Trust argued that it had superior title because the HOA foreclosure sale extinguished the Bank’s deed of trust.

The Bank argued that the sale did not extinguish its lien because the sale violated the automatic stay and was thus void under Nevada and 9th Circuit precedent. Holding that the Bank lacked prudential standing to assert a violation of the automatic stay, the District Court granted summary judgment in favor of the Trust and dismissed the remaining claims against the HOA. The Bank appealed to the Ninth Circuit.

**Analysis:** No one disputed that the Bank had constitutional standing under Article III because it had an injury traceable to the actions by the HOA. Instead, the issue was whether the Bank had prudential standing to challenge an action as violating the automatic stay under Ninth Circuit authority, including *Tilley v. Vucurevich (In re Pecan Groves)*, 951 F.2d 242 (9th Cir. 1991) (holding that a creditor has no independent standing to appeal an adverse decision regarding a violation of the automatic stay).

The majority distinguished *Pecan Grove* on the basis that the Bank was not appealing an adverse decision regarding the automatic stay and was not suing nondebtor third parties in a bankruptcy case. Instead, the appeal was about standing in a suit outside of bankruptcy court.

The Nevada quiet title statute permits suit by “any person against another who claims an . . . interest in real property, adverse to the person bringing the action.” Nev. Rev. Stat. § 40.010. Thus, Nevada law conferred standing on the Bank to pursue a quiet title action in District Court. The majority interpreted Nevada law as invalidating foreclosure sales that were conducted in violation of the automatic stay and noted that such sales are likewise “without effect” under Ninth Circuit precedent. Thus, the automatic stay was only incidentally pertinent and although it was the predicate act for the result, it was not the source of the remedy. To put it another way, although “the factual voidness of the Property’s transfer is a result of federal bankruptcy law . . . the consequences of such a void transaction for purposes of a Nevada quiet title action are controlled by Nevada’s property laws.” As the foreclosure sale was void, the majority concluded that the Bank had superior title and reversed the District Court’s grant of summary judgment and remanded for further proceedings.

Judge Forrest dissented. Citing Ninth Circuit precedent, Judge Forrest noted that “the automatic stay does not protect litigants pursuing claims that are adverse or unrelated to the distribution of the debtor’s estate.” See *Magnoni v. Globe Inv. & Loan Co. (In re Globe)*, 867 F.2d 556, 558-60 (9th Cir. 1989). Under *Globe*, the Bank is not within the class of persons possessing the right to sue under the automatic stay because it was not acting in its role as a creditor, nor was it protecting or benefitting the estate. Judge Forrest recognized that foreclosures in violation of the stay are void, not merely voidable, but that “does not necessarily mean that anyone dissatisfied with conduct it believes violated the automatic stay may claim protection under § 362.”

Judge VanDyke, the author of the majority opinion, wrote a separate concurrence to further explain why Judge Forrest’s dissent was incorrect. Judge VanDyke disagreed with the premise that only certain parties may claim that an action is void. If only certain parties

are allowed to set aside an action, the transfer is voidable, not void. He interpreted recent Ninth Circuit case law as abandoning prior precedent holding that stay violations are voidable, not void. He further stated that it was “admittedly accurate (albeit wrong)” to say that the automatic stay does not protect individual creditors with regard to “prudential standing in a bankruptcy proceeding.” He went on to say that the circuit’s “bankruptcy proceeding jurisprudence is internally inconsistent,” and that he saw “no reason to extend the *outdated* side of that inconsistency to effectively censor a party from presenting a factually-true argument in the context of its state-law claim outside of a bankruptcy proceeding.”

**Takeaway:** The majority opinion indicates that any injured party outside of bankruptcy likely has standing to assert that an action in violation of the stay is void, at least for purposes of pursuing rights under certain state statutes. However, the parties did not ask, and the opinion does not address, the HOA and Trust’s ability to retroactively annul the stay. It also fails to address whether the Bank should have instead first sought relief in the bankruptcy case. A more fundamental question may be the validity of Judge VanDyke’s opinion in his concurrence that current bankruptcy jurisprudence is “outdated” and needs to be “corrected.”

***Albert v. Golden (In re Albert), 998 F.3d 1088 (9th Cir. June 10, 2021)***

**Issue:** Can claim preclusion apply to an exemption decided in a chapter 13, to bar relitigation in a converted chapter 7?

**Holding:** Yes, *Law v. Siegel* does not bar bankruptcy courts from invoking the doctrines of claim and issue preclusion.

**Background:** This case arose from an order denying the debtor’s claimed exemption for two assets. The debtor, a lawyer who represented herself at the Ninth Circuit, scheduled a claim in her chapter 13 petition against Ford Motor Company for state court litigation valued at “\$500,000 TBD” and accounts receivable from former clients valued at “\$500,000 TBD.” She listed both claims as exempt under California law, the claim against the automaker for a personal injury lawsuit would only be exempt if the proceeds were necessary for the support and maintenance of the debtor and her dependents or was property not subject to enforcement of a money judgment. She listed the account receivables as exempt property not subject to enforcement of a money judgment. As a creditor, Ford Motor Company objected to the claim exemption, as did the chapter 13 trustee.

The bankruptcy court denied the claim exemptions and the debtor did not appeal. The case converted to chapter 7 and the debtor again sought to exempt the claims, but this time, she listed the claims in amended schedules as worth almost \$2 million.

The bankruptcy court again denied the exemption, finding claim preclusion applied because the issue was already decided before conversion. The BAP affirmed.

**Analysis:** On appeal, the debtor argued that *Law v. Siegel* abrogated prior decisions, effecting a bar on bankruptcy courts from denying exemptions on equitable grounds, such as claim preclusion. In other words, after *Law v. Siegel*, bankruptcy courts could not employ the doctrine of issue and claim preclusion, despite precedent holding otherwise.

The Ninth Circuit rejected this contention, finding that *Law v. Siegel* involved a “markedly different situation.” In *Law v. Siegel*, the debtor qualified for an exemption under California’s exemption statutes, but because of the debtor’s misconduct, the bankruptcy court decided to apply the exemption’s value to fees the trustee had incurred. The Supreme Court reversed because the Code prohibits using exempt funds for administrative expenses and noted that the bankruptcy court lacked authority to surcharge the debtor’s exemption.

A bankruptcy court’s equitable powers must yield to the Code’s more specific mandates. In *Albert*, however, there was no Code provision that barred the bankruptcy court from deeming prior orders, that denied the claimed exemptions, to be preclusive. Here, the orders were deemed final judgments “determining all issues regarding the claimed exemptions.” Notably, the debtor never appealed the orders denying her claimed exemptions. Thus, at this stage, they were binding, even if the debtor believed the issue to be wrongly decided.

In response, the debtor argued that there was no specific statutory basis for refusing to allow the claim exemption in the converted chapter 7. The Ninth Circuit again distinguished *Law*, explaining that there, the debtor was statutorily entitled to the exemption, whereas here, by operation of an earlier order, the debtor was not entitled to the exemption.

Since the BAP had focused on claim preclusion in its analysis, so did the Ninth Circuit. Claim preclusion bars successive litigation of an issue of fact or law actually litigated and resolved in a valid court determination. To prevail, the party asserting preclusion must show that (1) the earlier issue is identical to the one which is sought to be relitigated, (2) that the first proceeding ended with a final judgment on the merits, and (3) that the party against whom issue preclusion is asserted was the party in the first proceeding.

All requirements were met. The Ninth Circuit rejected the debtor’s argument that because she asserted different values between her chapter 13 and 7, that issue preclusion should not apply. The Ninth Circuit affirmed the BAP’s order affirming the bankruptcy court.

**Takeaway:** The equitable doctrines of claim and issue preclusion were not abrogated by *Law v. Siegel*.

***Kurtin v. Ehrenberg (In re Elieff)*, 2022 WL 832417 (9th Cir. BAP March 21, 2022)**

**Issue:** Is a security interest that has been reduced to a judgment and secured by lien still subject to subordination under § 510(b)?

**Holding:** Yes, § 510(b) mandates subordination of damage claims arising from the purchase or sale of a security, even if the purchase or sale has been reduced to a judgment and secured by a lien.

**Background:** The debtor and creditor had been business partners for years, but the relationship deteriorated, and they sued and countersued each other. The parties reached a settlement, whereby the partner-creditor transferred his interest in the business to the partner-debtor in return for four payments in future years totaling some \$49 million. The settlement agreement did not apportion the payments between the value of the business and other claims that the creditor had against his former business partner, such as breach of contract, fraud, or embezzlement. Under the agreement, the partner-debtor and the business were both liable for \$49 million.

The debtor defaulted and the creditor obtained a jury verdict for \$24 million. The debtor and the business filed chapter 11 petitions that were converted to chapter 7. The verdict became a judgment that the creditor recorded as a lien against property of the debtor and his businesses.

The trustee moved to subordinate the creditor's claims and lien. The bankruptcy court granted the trustee's motion and the creditor appealed.

**Analysis:** Section 510(b) "mandates the subordination of damages claims arising from the purchase or sale of a security." *Am. Broad. Sys., Inc. v. Nugent (In re Betacom of Phx., Inc.)*, 240 F.3d 823, 827 (9th Cir. 2001). The Ninth Circuit broadly interprets the scope of § 510(b). A claim "arises from" the purchase or sale of securities whenever it shares a "nexus or causal relationship" with the purchase or sale of securities.

The BAP saw no material difference between this case and *Pensco Tr. Co. v. Tristar Esperanza Props., LLC (In re Tristar Esperanza Props. LLC)*, 782 F.3d 492, 495 (9th Cir. 2015), where the court rejected the debtor's argument that § 510(b) did not apply to his claim because his membership interest in Tristar had been reduced to a judgment as of the petition date. In *Tristar*, the Ninth Circuit held that the claim in bankruptcy arose from the sale of a security interest of the debtor, and the creditor's claim originated from a failed sale, and subsequent arbitration on the valuation of the creditor's interest. Thus, there was a direct causal link between the creditor's claim and the purchase and sale of an equity interest.

This case is substantially similar; the settlement agreement and its subsequent breach that resulted in a jury verdict had divested the creditor of his interest or rights in the joint entities. Therefore, § 510(b) required subordination of his claim because there was a direct causal link between the creditor's claim and the purchase and sale of an equity interest. The public policy implications for § 510(b) are to ensure that creditors of the

debtor are paid before equity interest holders, who under general business law principles, have bargained for the potential of a greater return in exchange for a greater risk of loss.

It did not matter that the claim had resulted from the debtor's violation of the provision of the settlement agreement. The BAP noted that the breach "shares a direct causal link with the conveyance of his equity interest." Further, because the settlement agreement did not apportion the value between the business and the claims that the creditor had against the business, the bankruptcy court was correct in declining to apportion the contract to avoid subordinating the whole claim. Under California law, apportionment is not permitted "of cash consideration within a contract when the contract itself does not provide some basis or means for attributing between the various items or services for which it was given."

The BAP also upheld the bankruptcy court's subordination of the lien by following Supreme Court precedent, *Johnson v. Home State Bank*, 501 U.S. 78 (1991), where the court held that "claim" under § 510(b) includes a mortgage lien. The creditor responded that liens ride through in a chapter 7, with which the BAP agreed, but then noted that the lien was still subordinated, not extinguished. The only difference is that if there were assets sufficient to pay all other creditors in full, the subordinated lien would kick in.

**Takeaway:** Depending on the applicable state contract law, practitioners should apportion the consideration in a corporate divorce between the value derived from the business and other claims that one former owner might have against another. If not, the entire claim arising from the divorce will be subordinated in bankruptcy. *Rochelle's Daily Wire*, *Converting a Claim Based on Securities to Judgment Won't Bar Subordination* BAP Says (March 28, 2022).

***Samba v. Int'l Petroleum Prods. & Additives Co. (In re Black Gold SARL), No. 21-168 (9th Cir. BAP Feb. 17, 2022)***

**Issue:** In a chapter 15 case where all three requirements of § 1517(a) are met, can recognition be denied on the basis that it was filed in bad faith?

**Holding:** The BAP reversed the bankruptcy court's decision and held that in a chapter 15 case, recognition of the foreign proceeding is mandatory if all three requirements of § 1517(a) are met and there is no public policy basis to deny it.

**Background:** Black Gold S.A.R.L. ("Black Gold") is a Monaco LLC that operated as a trading company and distributor offering oil and lubricant products in Europe, Africa, and Asia. Its sole shareholders are Lorenzo Napoleoni and his wife, Sofia, Italian citizens who reside in Monaco. Mr. Napoleoni is Black Gold's manager and CEO. Black Gold has no other employees, officers, or directors.

IPAC is a California-based petroleum additive manufacturing and sales company. IPAC is Black Gold's largest creditor; more than 96% of Black Gold's debt is owed to IPAC.

In 2016, Black Gold agreed to be a sales representative and exclusive distributor of IPAC products in Europe. Unbeknownst to IPAC, Mr. Napoleoni, formed a competing additives business, PXL, with a former IPAC employee. IPAC alleged that Black Gold had misappropriated its trade secrets and customer lists to establish the competing business. IPAC then initiated an arbitration in California where the arbitrator awarded IPAC almost \$1.1 million. The US District Court in California confirmed the arbitration award.

IPAC believed that Mr. Napoleoni had fraudulently transferred Black Gold's assets, and IPAC commenced discovery in California to identify assets or transfers of assets. Black Gold filed an insolvency proceeding in Monaco ("Monegasque Proceeding"). The Monegasque court appointed Jean-Paul Samba as the trustee. Mr. Samba, as Foreign Representative, filed a chapter 15 petition and moved for recognition in the California bankruptcy court. The chapter 15 filing imposed an automatic stay on discovery.

Mr. Samba sought recognition of the Monegasque Proceeding as a foreign main proceeding under § 1517(b)(1). IPAC opposed recognition, arguing that the Monegasque Proceeding and the chapter 15 case were shams to protect Mr. Napoleoni and shield fraudulently transferred assets.

The bankruptcy court discovered that Mr. Napoleoni was paying Mr. Samba's attorney's fees and that Mr. Samba's counsel represented Black Gold in California district court and was representing Mr. Napoleoni in litigation in Ohio. The bankruptcy court found that Mr. Samba was not acting as a true fiduciary and that the facts cast doubt on the integrity of the proceeding and Black Gold's good faith.

The bankruptcy court held that, based on the misconduct and bad faith of Black Gold, its insiders, Mr. Samba, and their attorney's, the case did not serve the purposes and objectives of § 1501, and it denied recognition of the Monegasque Proceedings on that basis. The bankruptcy court made no findings under § 1517. Mr. Samba appealed.

**Analysis:** In this decision, the BAP analyzed the requirements for recognition of a foreign proceeding in a chapter 15 case.

One of the stated objectives of chapter 15 is to provide for cooperation between courts in the U.S. and those abroad by providing "effective mechanisms for dealing with cases of cross-border insolvency." See 11 U.S.C. § 1501(a). Section 1517(a) provides that recognition "shall" be granted if (1) the foreign proceeding is a main or non-main proceeding, (2) the foreign representative is a person or body and (3) the petition meets the requirements of § 1515. The only exception to granting recognition when the requirements of § 1517(a) are met is § 1506. This section allows courts to refuse recognition if the action would be manifestly contrary to the public policy of the United States.

Mr. Samba argued that recognition of the Monegasque Proceeding was proper under § 1517(a) because: (1) Black Gold was an eligible debtor under § 109(a); (2) the

Monegasque Proceeding was a "foreign proceeding" under § 101(23), and as trustee he was qualified as a "foreign representative" under § 101(24); (3) the Monegasque Proceeding was a "foreign main proceeding" under § 1502(4); (4) the petition satisfied § 1515; and (5) recognition was not manifestly contrary to U.S. public policy under § 1506.

There was no dispute in the bankruptcy court that these three requirements were satisfied. The BAP held that the bankruptcy court erred by denying recognition under § 1501 because "section 1501 does not control recognition of a foreign proceeding. Rather, recognition is governed by §§ 1515 through 1524." Additionally, the BAP could find nothing manifestly contrary to US public policy to deny recognition.

**Takeaway:** A bad faith filing is no basis for denying recognition of a foreign main proceeding under chapter 15 if all three requirements of § 1517(a) are met.

Although the foreign proceeding was entitled to recognition the court is not "helpless when faced with misconduct or bad faith in a chapter 15 case." After recognition, the court "has a considerable amount of discretion." If there is misconduct or bad faith, the court's tools include relief from the automatic stay, abstention, or dismissal.

**Kwong v. Aykiran (In re Aykiran), 2022 WL 214816, (9th Cir. BAP January 25, 2022)**

**\*Note that a Notice of Appeal to the Ninth Circuit was filed on Feb. 28, 2022.**

**Issues:** (1) Whether the bankruptcy court erred in dismissing the creditor's claims?

(2) Whether the bankruptcy court abused its discretion in denying the creditor leave to amend?

**Holding:** (1) No, the bankruptcy court did not err in dismissing the creditor's claims.

(2) Yes, the bankruptcy court abused its discretion in denying leave to amend the § 727 claims.

**Background:** This case arose out of the bankruptcy court's dismissal with prejudice of the creditor's §§ 523 and 727 claims against the debtor. The debtor manufactured Turkish Towels and sold them in the United States. He had several entities for his operations, one Turkish entity and three California limited liability companies (collectively "entities").

The creditor loaned the debtor \$537,145.50 ("Loan") based on allegedly false representations that: (1) the debtor was the sole owner of the Turkish entity; (2) that the Turkish entity owned a factory; (3) that the factory could manufacture large quantities of high-quality Turkish Towels; (4) that the Turkish entity qualified for expense reimbursements from the Turkish government; (5) that the debtor was an established businessman; and (6) that he had the intent and ability to repay any funds advanced.

The parties agreed that the Loan would be paid from gross revenues of Turkish Towel sales. Under the agreement, the creditor would be the sole buyer of Turkish Towels,

would dictate production, and would be required to approve all sales. After repayment of the Loan, profit would be split between the creditor's entities and the debtor's entities.

The business relationship deteriorated; first the debtor did not provide Turkish Towels to the creditor. Second, the debtor allegedly prevented creditor's agents from observing factory operations. Third, the debtor transferred to his wife, "rights and control" in the entities, which he had previously granted to the creditor, and the debtor's wife began importing her own line of Turkish products using the debtor's entities. Fourth, the debtor ceased operating one of the entities that was profit-sharing with creditor's entity. The debtor's wife established her own entity with the alleged intent and purpose of hindering and defrauding the debtor's creditors. The creditor alleged that through these actions, the debtor diverted and dissolved the means and sources from which he could repay the Loan, diverted business profits, and put assets and profits out of the reach of his creditors.

The creditor sued in state court and debtor filed his chapter 7 petition before trial commenced. The creditor filed an adversary proceeding against the debtor to except the debt from discharge under §§ 523(a)(2)(A) and (a)(6) and to deny him discharge under § 727(a)(2)(A), (a)(2)(B), (a)(3), (a)(4)(a), and (a)(5). The creditor amended his complaint twice, but ultimately all claims were dismissed with prejudice. The creditor appealed.

**Analysis:** In an unpublished opinion, the BAP affirmed the dismissal of the §§ 523(a)(2)(A), 523(a)(6), and 727(a)(2)(B) claims with prejudice; vacated the judgment and the dismissal of the §§ 727(a)(2)(A), (a)(3), (a)(4)(a), and (a)(5) claims with prejudice; and remanded with instructions to dismiss the §§ 727(a)(2)(A), (a)(3), (a)(4)(a), and (a)(5) claims with leave to amend.

#### Section 523(a)(2)(A)

Section 523(a)(2)(A) exempts from a debtor's discharge "any debt . . . for money, property, services, or . . . credit, to the extent **obtained by** . . . false pretenses, a false representation, or actual fraud" (emphasis added). The creditor sought to exempt from discharge both the Loan debt and nonspecific debt for lost profits. The BAP concluded that neither debt was exempt because the creditor could not show that the debtor fraudulently created the debts through the transfer of control to the debtor's wife and her entities.

Addressing the Loan debt, the BAP distinguished *Husky International Electronics Inc. v. Ritz*, 578 U.S. 356 (2016), where the Supreme Court held that the term actual fraud as used in § 523(a)(2)(A) encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation. In *Husky*, the bankrupt debtor only became potentially and partially liable for the debt under a Texas veil-piercing statute when he drained the corporation of assets that it could have used to pay creditors. Here, however, the debtor did not originally owe the debt, one of the entities owed it to the creditor's entity and no veil-piercing theory had been advanced. Further, the Supreme Court in *Husky* remanded for a determination of whether the alleged fraudulent scheme satisfied the "obtained by" requirement. Here, the BAP rejected such a broad reading of

“obtained by,” and clarified that in *Husky*, the fraudulent acts potentially created the debt at issue. Here, the debtor was essentially arguing that the transfer of control to the debtor’s wife and her entity somehow transformed creditor’s preexisting Loan debt into a nondischargeable debt. The Loan, however, was not “obtained by” the alleged subsequent transfer of control. Thus, the bankruptcy court did not err in dismissing the claim.

Addressing the lost profit debt arising from breach of the agreement, the BAP again analyzed *Husky*. In *Husky*, the Supreme Court observed that “the transferor does not obtain debts in a fraudulent conveyance. But the recipient of the transfer—who, with the requisite intent, also commits fraud—can obtain assets by his or her participation in the fraud. If that recipient later files for bankruptcy, any debts traceable to the fraudulent conveyance will be nondischargeable under § 523(a)(2)(A).” 578 U.S. at 365. Here, the transferor was the debtor, but he was not the transferee or recipient. Therefore, he did not obtain or create a lost profit debt by fraud as required by § 523(a)(2)(A).

Further, the BAP noted that the creditor lacked standing to pursue a payment from debtor because the lost profits debt would be owed to the creditor’s entity under the terms of the agreement. The creditor also failed to assert facts that could prove the debtor harbored ill intent when entering the agreement with the creditor. The damages for lost profits were also too speculative. Thus, the bankruptcy court did not err in dismissing the claim.

#### Section 523(a)(6)

Section 523(a)(6) excepts from discharge any debt for “willful and malicious injury by the debtor to another entity or to the property of another entity.” The lost profit debt alleged here was a breach of contract debt. Debts resulting from an intentional breach of contract are not actionable under § 523(a)(6) unless the breach was accompanied by tortious conduct that resulted in willful and malicious injury. A bankruptcy court applies a two-part test: (1) it must determine if the debtor’s conduct was tortious under state law, and (2) it must determine if the debtor’s conduct was also willful and malicious. Here, the tortious conduct requirement was not satisfied; under California law, fraud is an intentional tort. The creditor did not “plausibly suggest” that the debtor’s alleged actions arose above intentional breaches of the agreement to the level of fraud. Thus, the bankruptcy court did not err in dismissing the claim.

#### Section 727 claims

The BAP concluded that the bankruptcy court did not err in dismissing the § 727 claims because they were too vague, scattershot, and contradictory to rise above the speculative level, even based on the assumption that the facts in the amended complaints were true.

Most notable is the BAP’s discussion of the alleged allegations under § 727 was that the debtor should be denied a discharge based on false statements and omissions in bankruptcy schedules and statements. The BAP noted that the entities owned the assets that were allegedly omitted from the schedules, and therefore the debtor’s scheduling of an ownership interest in the entities would sufficiently disclose his interests. The creditor

failed to allege value as to any of the personal assets and those were likely valueless. Similarly, as to nondisclosure of liabilities, those belonged to the entities and therefore were captured in scheduling an ownership interest in the entities.

#### Denial of leave to amend

A bankruptcy court should grant leave to amend “unless it determines that the pleading could not possibly be cured by allegations of other facts.” The court should consider the Forman factors when determining whether to grant leave to amend: (1) undue delay; (2) bad faith or dilatory motive by the plaintiff; (3) repeated failure to cure deficiencies by previous amendments; (4) undue prejudice to the defendant; and (5) futility of amendment. The consideration of prejudice to the defendant is paramount.

Regarding the § 727 claims, the BAP could not conclude with certainty that the claims were doomed by legal impossibility to the extent that they were based on allegations other than fraudulent transfer of the entities to debtor’s wife or relate to non-disclosure of non-estate assets. Thus, leave to amend should have been granted when the bankruptcy court did not find lack of futility, undue delay, or undue prejudice to the debtor.

**Takeaway:** While *Husky* extended “obtained by” under § 523(a)(2)(A) to potentially include obtaining debts through a fraudulent conveyance scheme, when applying that holding to lost profit debts, it is actionable only against the recipient of funds and not to the transferor of funds. It is important not to overread *Husky*, as the creditor attempted to do in this case, in a manner that would transmute any post-transaction fraudulent transfer into grounds for an exception to discharge.

#### ***LVNV Funding, LLC v. Andrade-Garcia (In re Andrade-Garcia), 635 B.R. 509 (9th Cir. BAP Jan. 11, 2022)***

**Issue:** Did the court err in awarding attorney fees under a Nevada statute that functions more as a sanction, rather than a purely fee-shifting provision?

**Holding:** Yes, the Nevada statute is aimed at governing litigation misconduct. Since the statute is procedural rather than substantive, federal law governs, and it was inappropriate to award attorney fees under the Nevada statute.

**Background:** This case arose from an attorney fee award to the debtor under a state statute. The debtor successfully objected to a creditor’s proof of claim and sought attorney fees against the creditor for a groundless and harassing claim.

The debtor filed a chapter 7, but then converted to a chapter 13. A creditor filed three proofs of claim in the case; all the claims were more than ten years old before the debtor filed for bankruptcy. The debtor objected under Nevada’s statute of limitation, arguing that the time to commence an action on the claims had expired a decade before the petition date. The debtor then requested attorney’s fees under a Nevada statute that provided for attorney fees as a sanction when the opposing party files or maintains a groundless or harassing claim or defense.

The creditor argued that, under the holding in *Midland Funding, LLC v. Johnson*, 137 S. Ct. 1407 (2017), filing the claims was not wrongful conduct and therefore attorney fees should not be awarded under the Nevada statute.

The bankruptcy court disallowed the claims under § 502(b)(1) because the claims were filed several years after the expiration of the applicable statute of limitations in Nevada and therefore were unenforceable under state law. The bankruptcy court awarded fees to the debtor under NRS § 18.010(2)(b), a fee-shifting statute.

**Analysis:** There is no general right to attorney fees for actions in bankruptcy cases. However, a prevailing party in a bankruptcy proceeding may be entitled to an award of attorney fees in accordance with applicable state law if state law governs the substantive issues raised in the bankruptcy proceedings. Under the doctrine established in *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), federal courts sitting in diversity apply state substantive law, but federal procedural law. When attorney fees are based upon misconduct by an attorney or party in the litigation, the matter is procedural and federal law governs.

The debtor argued that the legislative history of the Nevada statute established that it was a purely fee-shifting statute. The court rejected that argument because the statute addressed a party's or attorney's conduct in the federal litigation and is therefore procedural and governed by federal law.

Further, the BAP concluded that even if the Nevada statute applied, the creditor's claims were not groundless. Under *Midland Funding*, the definition of claim under § 101(5)(A) is a "right to payment," which is broad enough to include unenforceable claims. When the statute of limitations has run on a claim, that is an affirmative defense against the claim. The statute of limitations under Nevada law affects a creditor's remedy but it does not destroy the substantive cause of action, rather the defense is a "waivable, non-jurisdictional, affirmative defense, for which the asserting party bears the burden of proof." The BAP reversed the bankruptcy court's award of attorney fees.

**Takeaway:** It is important to remember the distinction in *Erie Railroad Co. v. Tompkins*, when applying state substantive law, federal procedural law will still apply.

***Koeberer v. California Bank of Commerce (In re Koeberer)*, 632 B.R. 680 (9th Cir. BAP Nov. 18, 2021)**

**Issues:** (1) Was the stay violated by the bank by filing a notice of trial, even though it took no action against the debtors?

(2) Did the debtors have standing to pursue a motion for contempt?

(3) Did the bankruptcy court err when it found that a merely technical violation of the automatic stay did not require sanctions?

(4) Did the bankruptcy court err when it declined to award damages?

**Holding:** (1) Yes, and even if the bank had only proceeded against the other defendants, it would still have violated the stay because the fraudulent transfer action was undertaken to recover a claim against the debtors.

(2) Yes, the debtors had standing to pursue a motion for contempt against the bank, but only under § 362(a)(1), and not § 362(a)(3).

(3) Yes, the bankruptcy court erred because § 362(k) provides that a court “shall” award sanctions for “any willful violation” and is therefore mandatory.

(4) No, the bankruptcy court did not err when it declined to award damages because the debtors offered no evidence of actual harm.

**Background:** This case arose from the debtors’ motion for contempt against a creditor for violating the automatic stay by continuing a state court action against the debtors. The plaintiff in the state court action had attempted to stay the litigation as to the debtors and continue pursuing its claim against the co-defendants, but the bank’s attempt was unsuccessful.

A married couple owned a corporation that borrowed \$2.75 million from a bank. The corporation gave the bank a security interest in all its property, and the couple gave unsecured, personal guarantees. Shortly after the corporation defaulted on the loan, the couple transferred their home and \$125,000 cash to a trust via gift deed for no consideration. A relative was the trustee and the couple’s adult children were the beneficiaries to the trust.

The bank filed a fraudulent transfer suit against the couple, the trustee, and the adult children in state court. Thereafter, the couple filed a chapter 7 petition. Two weeks later, the bank served a notice of trial for the state court on the debtors’ counsel. The same day, the bank filed a notice of stay in state court informing the state court that the suit was stayed as to only the debtors due to the bankruptcy. The state court rejected the notice of stay because it was not filed by the party requesting the stay. The bank did not withdraw the notice of trial as to the debtors or any other defendants.

The debtors filed a contempt action in their bankruptcy seeking \$5,000 in damages plus attorney’s fees. The bankruptcy court found that the bank violated the stay because it (1) knew about the stay and (2) had filed the notice of trial even though the Bank had taken no other action to advance the case. The bankruptcy court declined to grant sanctions because it deemed the stay violation to be only “technical.” The bankruptcy court also held that the debtors lacked standing to pursue a contempt action under either § 362(a)(1) or (3), finding that only the chapter 7 trustee owned the fraudulent transfer claim and therefore had standing.

**Analysis:** The BAP agreed with the bankruptcy court that the Bank violated the automatic stay but disagreed that it was merely a technical violation. The filing of a chapter 7 petition automatically creates an estate containing all legal and equitable interests of the debtor in property as of the commencement of the case. The trustee administers the estate and

is the representative of the estate. In addition to the creation of the estate, the filing of a petition enacts the automatic stay which effects an immediate freeze of the status quo by precluding and nullifying post-petition actions, judicial or nonjudicial, in nonbankruptcy for or against the debtor or affecting the property of the estate.

Specifically addressing the automatic stay, § 362(a)(1) stays “the commencement or continuation . . . of a judicial . . . action or proceeding against the debtor . . . to recover a claim against the debtor . . .” As the BAP summarizes, this section stays two types of actions. The first applies to any action against the debtor that was filed, or could have been filed, before the bankruptcy filing. The second applies to any action to recover a claim against the debtor that arose prepetition.

The BAP concluded that the Bank violated the automatic stay under § 362(a)(1). The evidence supported the bankruptcy court’s finding that the bank knew that the automatic stay applied at least to part of its state court complaint. Despite this knowledge, the Bank filed a notice of trial and intended to prosecute the complaint against the co-defendants. This was a violation of § 362(a)(1), which prohibits the continuation of judicial actions against the debtor. The BAP followed Second Circuit precedent, *FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125, 131–132 (2d Cir. 1992), which held that a creditor’s fraudulent transfer action against a transferee from the debtor, to the extent the action seeks satisfaction of a claim against the debtor, is stayed by § 362(a)(1). Thus, proceeding against the co-defendants, who were the transferees, was still a violation of the automatic stay, because in practical effect, an outcome in favor of the Bank would recover against the Debtors, the transferors, in violation of the stay.

The BAP concluded that the Bank violated the automatic stay under § 362(a)(3). A fraudulent conveyance action becomes property of the estate upon the filing of the bankruptcy petition. The trustee’s standing to sue on behalf of the estate is exclusive and therefore a debtor’s creditors cannot prosecute such claims belonging to the estate absent abandonment. Pursuing a claim against the trustee of the trust where the property was held was an act to “exercise control over property of the estate,” therefore violating § 362(a)(3). Even after the Bank said in state court that it was not pursuing a claim against the debtors, it continued pursuing its claim against the trustee of the trust, thereby violating the automatic stay.

The BAP concluded that the debtors had standing to assert a stay violation, reversing in part, and affirming in part the bankruptcy court’s decision. First, the BAP agreed that the debtors lacked standing to pursue a stay violation under § 362(a)(3). Since the debtors did not own the claim because it belonged to the estate, the claim was exclusively represented by the chapter 7 trustee. Therefore, interference with the fraudulent transfer claim could only harm the estate, and the debtors could suffer no actual damage from this violation.

Second, the BAP disagreed that the debtors lacked standing to pursue a stay violation under § 362(a)(1). The automatic stay under § 362(a)(1) protects the debtors “from any

action to collect their prepetition debts, even actions to which they were not (or were not required to be) parties.” Interestingly, the BAP focused on the notice of trial in its analysis, specifically that it “appeared to be indiscriminately directed at all parties,” including the debtors, concerning all causes of action. This suggests that had the Bank pursued its action only against the trustee of the trust, that the debtors may have lacked standing to assert a stay violation under § 362(a)(1). There would have still been a violation under § 362(a)(3), but as discussed above, only the trustee would have had standing to pursue a contempt action under § 362(a)(3).

Finally, the court concluded that § 362(k) is mandatory, and the bankruptcy court only has discretion when determining the severity of sanctions. The statute provides, that the bankruptcy court “shall” award sanctions to “any individual injured” by “any willful violation of a stay provided by” § 362. The debtor must still show injury and the court may consider the severity of the violation when deciding the amount of sanctions, but there is no category for violations so minor that it negates the mandatory language of § 362(k).

The BAP affirmed the bankruptcy court’s denial of actual and punitive damage because the debtors failed to present evidence in support of their motion. The BAP remanded to the bankruptcy court to consider whether the attorney fees requested were reasonable. The bankruptcy court had denied the debtors’ request for attorney fees on the grounds that the stay violation was merely technical, and the BAP believed that on remand, the bankruptcy court may find some portion of Debtors’ attorney fee request reasonable.

**Takeaway:** Postpetition pursuit of a fraudulent conveyance claim in state court, even when the debtor is not a party, maybe still violate the automatic stay under § 362(a)(1) and will likely violate the automatic stay under § 362(a)(3).

***In re Stuart, 632 B.R. 531 (9th Cir. BAP Nov. 10, 2021)***

**\*Note that a Notice of Appeal to the Ninth Circuit was filed on Dec. 17, 2021.**

**Issue(s):** Whether § 362(a)(3) imposes an affirmative duty on a creditor to release a prepetition garnishment

**Holding:** The BAP affirmed the bankruptcy court's ruling that the City of Scottsdale, Arizona did not violate the automatic stay by not lifting garnishments against the debtor's bank accounts.

**Background:** The City of Scottsdale, Arizona (“City”) obtained a \$30,000 judgment against Mark Stuart (“Debtor”) and served a writ of garnishment on Bank of America, where Debtor had three accounts. The bank froze the accounts, which held about \$9,000.

The Debtor filed a chapter 13 petition. The Debtor’s attorney sent messages to both the City and the bank demanding the release of the attachment. The City’s attorney responded by filing a motion to stay the state court litigation.

The Debtor filed a motion to vacate the garnishment in the state court. The city's attorney responded by saying that the city did not oppose the bank releasing the funds and would abide by whatever decision was made in accordance with the Bankruptcy Code. The city argued that under § 362(a), it was required to stay the garnishment proceedings, but it was not required to dismiss them.

The Debtor filed a motion for sanctions for in bankruptcy court for willful violation of the stay under § 362(k). The bankruptcy court initially granted the motion before the Supreme Court handed down its decision in *City of Chicago v. Fulton*, 141 S. Ct. 585 (2021). Upon reconsideration, the bankruptcy court vacated its minute order and denied Debtor's stay violation motion. The Debtor appealed.

**Analysis:** The BAP affirmed the bankruptcy court's decision and held that the bankruptcy court correctly determined that the City did not violate § 362(a)(3) by failing to move to release the garnishment under *Fulton*. The BAP reasoned that the City's failure to affirmatively dismiss a prepetition writ of garnishment or to release frozen funds was not a continuation of a judicial proceeding against the Debtor under (a)(1); was not an attempt to enforce a judgment under (a)(2); was not an act to obtain estate property under (a)(3); and was not an attempt to recover from property of the estate under (a)(6).

**Takeaway:** Section 362(a)(3) does not impose an affirmative duty on the creditor to release its garnishment.

While the BAP's decision under (a)(3) is not surprising because in light of *Fulton*, this opinion is significant because it addressed and did not find violations under any of the other subsections of § 362(a).

***Perryman v. Dal Poggetto (In re Perryman)*, 631 B.R. 899 (9th Cir. BAP Oct. 8, 2021)**

**Issue:** Do continuances or status hearings in state court divorce proceedings violate the automatic stay?

**Holding:** No, these types of hearings only preserve the status quo of a prepetition action and therefore do not violate the automatic stay under § 362(a)(1) or (5).

**Background:** This case arose from a motion for contempt for violation of the automatic stay relating to a state court divorce proceeding. The debtor was divorcing his wife in California. The California Court had awarded the couple's home to the husband and gave the wife a \$29,000 "equalization payment" to be evidenced by a note and a mortgage. The husband signed neither the note, nor the mortgage. Before the wife court finalize the divorce proceedings where the clerk of the court would sign the note and mortgage, the husband filed a chapter 13 petition.

The state court hearing was continued twice, but no other action was taken in state court. The wife's counsel obtained an adjournment to a date that was more than two years after

the chapter 13 filings. The debtor filed a motion for contempt, claiming that the requests for continuances were willful violations of the automatic stay under § 362(a)(1) and (5). The debtor also wanted \$1,400 in attorney fees for prosecuting the contempt proceeding.

**Analysis:** There is no Ninth Circuit precedent squarely on point. The BAP cited to bankruptcy court decisions in Texas and Chicago, holding that status conferences and continuances do not violate the automatic stay. The BAP cited analogous precedent from the Ninth Circuit, *First Nat'l Bank of Anchorage v. Roach (In re Roach)*, 660 F.2d 1316 (9th Cir. 1981), where the Ninth Circuit held that postponement and rescheduling of a prepetition foreclosure sale does not violate the automatic stay. The court declined to apply the debtor's interpretation of continuation of judicial action in § 362(a)(1), "to include a continuance or status hearing" because those actions do not alter the status quo, and therefore did not violate the automatic stay under 362(a)(1) or (5).

The debtor did not introduce transcripts from the state court hearings, which could have altered the BAP's decision, had more transpired than just continuances. The state court minutes only showed continuances or the wife's request for them. The BAP affirmed the bankruptcy court.

**Takeaway:** A continuance or status hearing does not violate the automatic stay under 362(a)(1) and (a)(5) because it maintains the status quo.

***Italiane v. Jeffrey Catanzarite Fam. Ltd. P'ship (In re Italiane)*, 362 B.R. 662 (9th Cir. BAP Oct. 4, 2021)**

**Issue:** Can a stipulated judgment in a state court action have preclusive effect in a nondischargeability action?

**Holding:** Yes, the stipulated judgment will likely have preclusive effect if the elements of issue preclusion are met.

**Background:** This case arose from a summary judgment motion, where the creditor moved for the bankruptcy court to recognize a state court stipulated judgment on a fraudulent concealment claim in favor of investors that had been induced to invest in the debtor's roofing products company. The bankruptcy court found that the \$1.5 million judgment was nondischargeable under § 523(a)(2)(A).

During the state court litigation, whereby investors in ArmorLite, debtor's company that specialized in a patented high-tech roofing system, were suing the debtor, who had been ArmorLite's prior owner, for fraudulent concealment of material facts regarding the marketability of the roofing system during ArmorLite's sale. Thereafter, the debtor filed a chapter 7 petition. The investors initiated a timely nondischargeability action under § 523(a)(2)(A) based largely on the same facts alleged in the state court proceeding. The bankruptcy court ultimately granted relief from stay so that the investors could litigate their fraud claims to final judgment in the state court. In doing so, the bankruptcy court specifically noted in its abstention order that the nondischargeability action would resume if necessary to determine the dischargeability of any fraud judgment that plaintiffs might

obtain in state court. In addition, the bankruptcy court noted that, if appropriate, it might consider applying issue preclusion to the state court's findings of fact and conclusions of law.

Before the state court trial commenced, the parties entered into a stipulated judgment. In the adversary proceeding, the investors moved for summary judgment on their nondischargeability action, based on the preclusive effect of the stipulated state court judgment. The bankruptcy court granted the motion, excepting the \$1.5 million judgment debt from discharge.

**Analysis:** The preclusive effect of a prior state court stipulated judgment may serve as a basis for granting summary judgment in an adversary proceeding. The BAP applied California law on issue preclusion, which is similar to other the issue preclusion law of other states and therefore has been included in this CLE material.

To find issue preclusion, California law requires: (1) the issue sought to be precluded from relitigation is identical to that decided in a former proceeding; (2) the issue was actually litigated in the former proceeding; (3) the issue was necessarily decided in the former proceeding; (4) the decision in the former proceeding is final and on the merits; and (5) the party against whom preclusion is sought was the same as, or in privity with, the party to the former proceeding.

The debtor argued that issue preclusion could not apply because the stipulated judgment did not contain stipulated facts. The BAP found that, even though the stipulated judgment did not include stipulated facts, it could still have preclusive effect. To find issue preclusion under California law, the court must find that the facts were actually litigated and necessarily decided for purposes of applying issue preclusion. Here, the debtor had agreed to entry of judgment on the plaintiffs' cause of action for fraudulent concealment, which necessarily included a finding that all elements existed to establish that cause of action. Therefore, the state court judgment established the individual elements of fraudulent concealment under California law. And in turn, those elements were the same as those needed to prove the investors' § 523(a)(2)(A) claim in the bankruptcy. Thus, the lack of stipulated facts did not prevent the bankruptcy court from applying issue preclusion in the nondischargeability action.

The court also addressed the issue of the parties' contractual intent to be bound. The BAP concluded that the debtor's actions objectively manifested an intent to be bound by the stipulated judgement. Specifically, the debtor raised issues of his mental capacity and argued that he mistakenly entered into the settlement agreement. The BAP rejected this argument, finding that the debtor's subjective intent was irrelevant to whether he objectively manifested an intent to bound. There was ample evidence in the state court record to support the debtor's objective intent to be bound to the settlement agreement, which included reading the settlement agreement into the record. The BAP affirmed the bankruptcy court.

**Takeaway:** A continuance or status hearing does not violate the automatic stay under 362(a)(1) and (a)(5) because it maintains the status quo.

***In re Duran*, 630 B.R. 797 (9th Cir. BAP July 27, 2021)**

**\*Note that a Notice of Appeal to the Ninth Circuit was filed on Sept. 2, 2021.**

**Issue(s):** Whether the bankruptcy court abused its discretion when it dismissed the debtor's case with prejudice after the debtor filed a voluntary motion to dismiss as of right under § 1307(b)?

Whether the bankruptcy court erred by failing to consider the best interests of creditors and the estate in its ruling?

**Holding:** The BAP affirmed the bankruptcy court finding no abuse of discretion and holding that a debtor's right to dismiss under § 1307(b) does not immunize the debtor from the consequences of an adverse § 349(a) determination.

**Background:** Chapter 13 debtor, Gabino Duran, had previously filed several bankruptcy cases. After filing his chapter 13 petition, Duran amended his scheduled three times. The first two amendments added a pending lawsuit, a judgment debt, two assets, and an increase in his proportionate interest in his residence. In his third amendment, Duran admitted that his income in 2016 and 2017 was not \$0.00 as initially reported, but was \$1,345,074 and \$1,424,611, respectively. Additionally, Duran revealed that he transferred more than \$50,000 worth of farm equipment less than a year before filing and that he owned and leased farmland to an insider, whose bank statements from February to October 2018 indicated revenues exceeding \$1 million.

Both the chapter 13 trustee and a creditor objected to Duran's plan. In the objection, the creditor argued that the case should be either dismissed or converted, but the creditor did not file a motion to dismiss or convert. The bankruptcy court held a two-day evidentiary hearing on plan confirmation in which the issues included Duran's good faith, or lack thereof.

Duran conceded that his plan could not be confirmed and filed a motion to dismiss under § 1307(b). The creditor filed an opposition to the motion to dismiss and asked for dismissal with prejudice under § 349(a) for egregious bad faith. Again, the creditor did not file a motion to dismiss under § 1307(c).

The bankruptcy court held a hearing on Duran's § 1307(b) motion and considered the entire record. Citing the four-part test in *In re Leavitt*, 171 F.3d 1219 (9th Cir. 1999), *aff'g* 209 B.R. 935 (9th Cir. BAP 1997), as governing authority the bankruptcy court dismissed with prejudice, after finding egregious and inequitable bad faith along with manipulation and abuse of the Bankruptcy Code. Duran appealed, and the BAP affirmed.

**Analysis:** The BAP first outlined the various bases for dismissal under § 1307. Section 1307(b) creates a right of dismissal upon motion by the debtor. A case may also be dismissed or converted for cause by motion under § 1307(c) when it is in the best interests

of creditors and the estate. The BAP clarified that although a §1307(c) dismissal for cause requires an inquiry as to the best interests of creditors and the estate, a dismissal under § 1307(b) does contain a cause component and, therefore, does not implicate a best interests analysis.

Because the motion in *In re Duran* was filed pursuant to § 1307(b), the bankruptcy court did not err by failing to consider the best interests of creditors and the estate in its ruling.

The BAP next clarified ambiguities when applying a § 349(a) analysis. First, the BAP distinguished between two different forms of dismissal with prejudice: the “weak form” and the “strong form”. The weak form can contain a temporary refiling prohibition or provide that a new filing will not apply the automatic stay to a particular creditor. On the other hand, the strong form “is tantamount to denial of discharge” and is reserved “for egregious circumstances and necessitates that courts proceed with caution and pay attention to due process requirements consistent with denial of discharge.”

The BAP next identified a second ambiguous term that impacts § 349(a) analyses: “bad-faith.” The BAP cautioned that the “bad faith” required to trigger a “with prejudice” dismissal under § 349(a) is not the same “bad faith” that is recognized as “cause” to dismiss or convert under § 1307(c). “Bad faith” under § 349(a) requires “egregious behavior,” while “bad faith” under § 1307(c) does not.

The BAP held that the bankruptcy court’s dismissal “with prejudice” was not an abuse of discretion. The bankruptcy court correctly conducted the § 349(a) bad faith analysis by examining the “totality of the circumstances through a four-consideration matrix” set forth in *In re Leavitt*.

Judge Klien, writing for the BAP, concluded that although *Leavitt* dealt with “cause” for dismissal under § 1307(a), he saw “no principled reason” why it should not also apply to § 1307(b) dismissals.

**Takeaway:** A § 1307(b) motion to dismiss can lead to a dismissal with prejudice pursuant to § 349(a) because every dismissal triggers the § 349(a) issue whether “cause” exists to order that dismissal be with prejudice.

### ***In re Perez*, 628 B.R. 327 (9th Cir. BAP June 17, 2021)**

**Issue:** What actions by a trustee are sufficient to constitute “causing recovery” of transferred property to sustain an objection to a homestead exemption under § 522(g)?

**Holding:** For the trustee's action to be the “cause” of the recovery, there must be “an explicit statement by the trustee to the debtor that the trustee intends to recover the property interest for the estate.”

**Background:** Thomas Perez (“Debtor”) recorded a Declaration of Homestead on his residence (“Residence”). He experienced financial difficulties and sought legal advice. His counsel suggested that he grant a third mortgage (“DOT”) to his sister, who had loaned him money in the past, and then wait one year before filing bankruptcy so that he

could avoid a § 547 preference action. Debtor signed his bankruptcy petition and supporting documents with the understanding that his counsel would not file before May 31, 2020. However, the petition was filed on May 14, 2020.

On his schedules, Debtor valued the Residence at \$625,000 with encumbrances of \$600,000, including the DOT. Debtor did not claim a homestead exemption on Schedule C, instead he claimed a wildcard exemption. At the 341 meeting, the trustee questioned Debtor about the DOT and stated that she intended to have a realtor look at his house. She did not say she was looking to avoid the DOT.

Recognizing that he was in “trouble,” Debtor hired new counsel, and promptly took steps to have the DOT reconveyed. He amended his schedules to claim a \$175,000 homestead exemption. Debtor's new counsel contacted the trustee and informed her that amended schedules had been filed and that the DOT would soon be reconveyed. The trustee filed an adversary proceeding to avoid the DOT. Debtor's sister recorded the reconveyance deed within days.

The trustee objected under § 522(g), asserting that, Debtor was not entitled to the homestead exemption because the DOT had been reconveyed because of her efforts. The bankruptcy court overruled the objection, finding that the trustee had not taken sufficient action to bar the Debtor's exemption. The trustee appealed.

**Analysis:** The BAP affirmed the bankruptcy court's decision and held that, when a trustee's action is not the cause of the recovery, § 522(g) does not bar an exemption in the recovered property. The BAP stated that its prior case, *In re Glass*, 164 B.R. 759 (9th Cir. BAP 1994), set a floor for determining what constitutes a recovery by the trustee: “an explicit statement by the trustee to the debtor that the trustee intends to recover the property interest for the estate.” Applying the standard from *Glass*, the BAP reasoned that in order for the trustee's action to be the cause of the recovery, “the debtor must be put on notice by an affirmative act or statement of the trustee that the transfer is avoidable and/or recoverable . . . and that the trustee intends to take action to recover the property interest.” Applying this standard, the panel found that the record supported the bankruptcy court's ruling.

**Takeaway:** The debtor must be put on notice by an affirmative act or statement of the trustee that the transfer is avoidable and/or recoverable under the Bankruptcy Code and that the trustee intends to take action to recover the property interest.

## Chapter 7

# Presentation Slides: Restructuring Challenges Facing Skilled Nursing and Assisted Living Facilities in Chapter 11: What Are They and How Do We Solve Them?

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## Restructuring Challenges Facing Skilled Nursing and Assisted Living Facilities in Chapter 11: What Are They & How Do We Solve Them?



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### Post-Acute Care and Senior Living at a Glance: Snapshot

**\$130B in annual revenue growing at 2.5% per year**

	# Investment Grade Properties	# Beds/ Units	Average Length of Stay
<b>IRF</b>	1,172	n/a	13 days
<b>LTAC</b>	365	26K	25 days
<b>SNF</b>	10,300	1,300K	146 days
<b>IL/AL/MC</b>	12,300	1,200K	22 months
<b>CCRC</b>	1,900	600K	EF 62 months Rental 35 months

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### Post-Acute Care and Senior Living at a Glance: Snapshot

**Major Players (by Key Service)**

LTCH/LTAC	IRF	SNF	IL and AL/MC	CCRC
				
Kindred Healthcare UPMC Rehabilitation Institute	Encompass Health Corp. (~10K beds) Select Medical Corporation (~5K beds)	Genesis Healthcare (~42K beds) The Ensign Group (~25K beds) ProMedica Senior Care (~22K beds) The Evangelical Lutheran Good Samaritan Society (~16K beds)	Brookdale Senior Living (~47K units) Holiday Retirement (~32K units) National Senior Campuses (~21K units) Ascension Living (~8K units)	Life Care Services LLC (~37K units) Erickson Living (~24K units)

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## Post-Acute Care and Senior Living

### Industry Overview

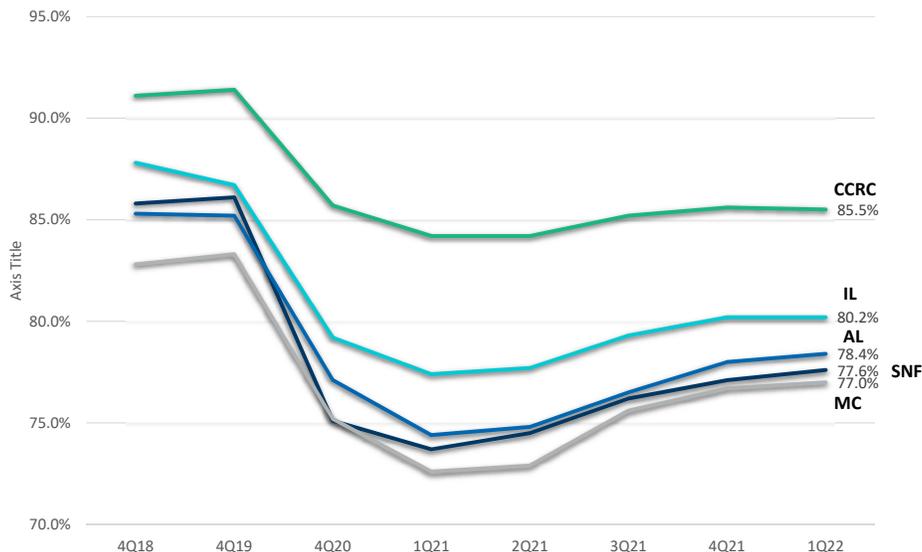
- PAC/SL among hardest sectors hit by COVID, with severe declines in occupancy and increased costs
- Over 186,000 COVID deaths (26% of US deaths) occurred among residents and staff of such facilities
- Stimulus funding only partially alleviated the estimated bottom-line COVID impact
- Expense growth continues to outpace reimbursement growth
- Liquidity is expected to tighten further as costs remain inflated and stimulus funding ends.
  - HHS began recoupment of Medicare Accelerated and Advance Payments in April 2021
  - 50% of payroll tax deferrals come due in December 2021

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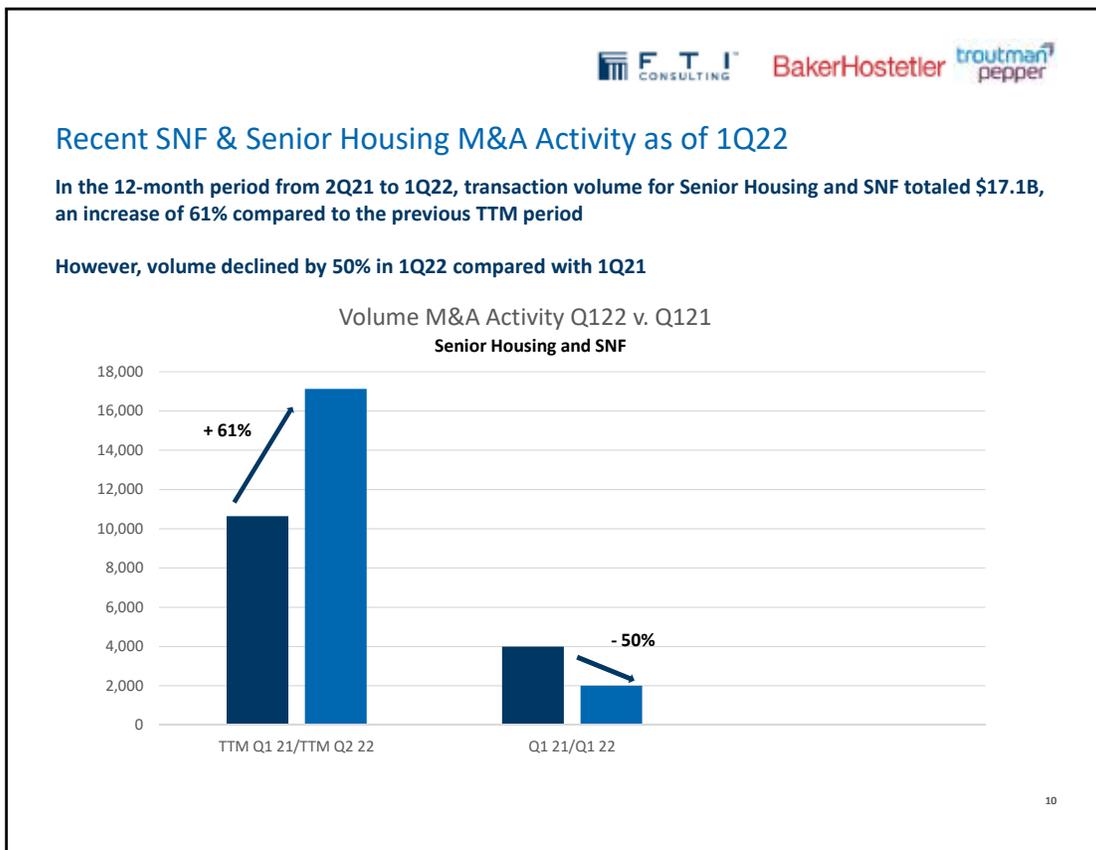
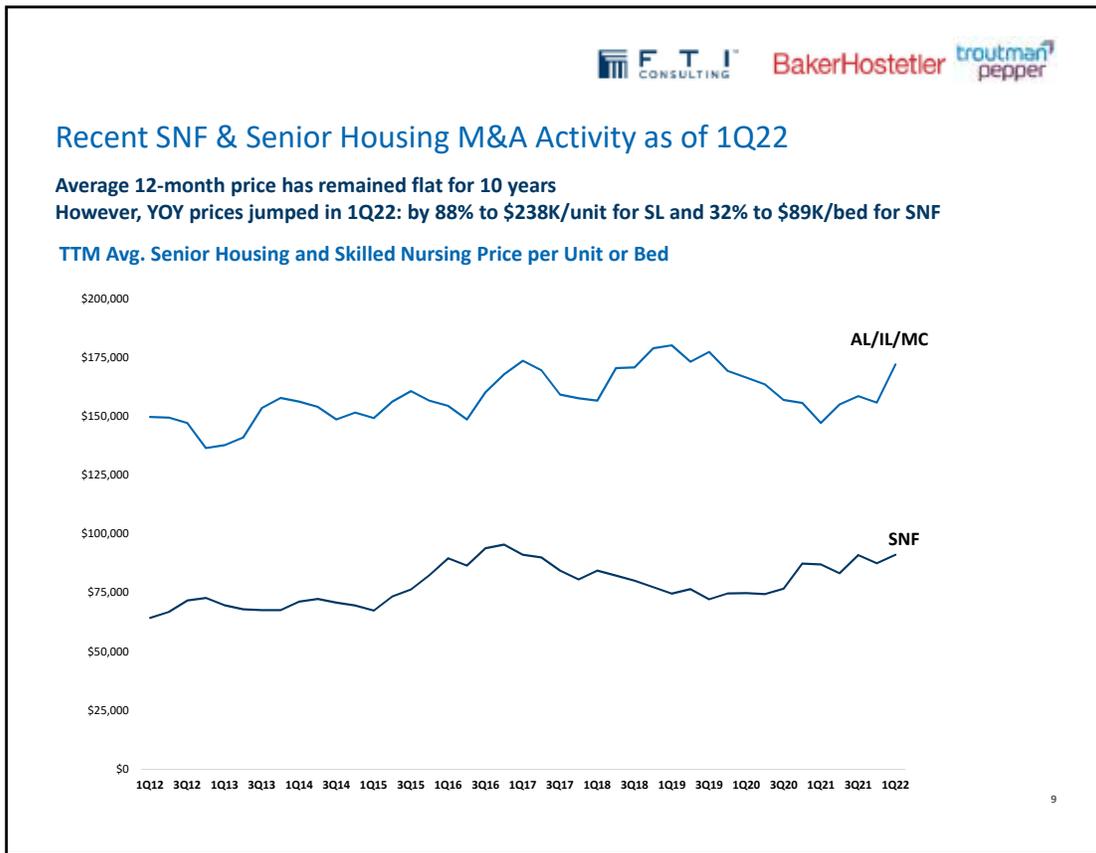


## Post-Acute Care and Senior Living at a Glance: Snapshot (PAC/SL)

Occupancy has been increasing but remains well below pre-COVID levels



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## Recent SNF & Senior Housing M&A Activity as of 1Q22

In the 12-month period from 2Q21 to 1Q22, transaction volume for Senior Housing and SNF totaled \$17.1B – an increase of 61% compared to the previous 12-month period.

### Top 5 Buyers & Sellers

Buyer Name	Type
Welltower	REIT (NYSE:WELL)
Ventas	REIT (NYSE:VTR)
Harrison Street RE Cap	Investment Firm (Private)
Lone Star	Investment Firm (Private)
PGIM Real Estate	Investment Firm (Private)

Seller Name	Type
New Senior Investment Group	Investment Firm (Private)
Fortress	Investment Firm (Private)
Healthpeak Properties Inc	REIT (NYSE:PEAK)
Northstar Healthcare	Investment Firm (Private)
The Freshwater Group	Investment Firm (Private)

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## Post-Acute Care and Senior Living

### Industry Overview

Longer-term market outlook is favorable as:

- U.S. aging population and chronic disease to fuel growth in next 10-15 years
- PAC/SL is viewed as essential to the continuum of care and demand is projected to exceed available beds/units within the next five years.
- As occupancy is slow to rebound, industry experts differ as to whether the shift to home health will be permanent.
  - Prior to the pandemic, home health providers estimated that 10%-15% of SNF patients could be safely cared for at home as opposed to in a facility after an acute-care discharge.
  - Home health providers point to increased direct referrals from physicians and to studies indicating patients' preference for being treated at home after a hospital stay.
  - However, the reality is that many SNF patients (particularly long-stay Medicaid) require 24/7, hands-on care that is not feasible with in-home care.

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### Post-Acute Care and Senior Living

**Opportunities/Tailwinds**  
Reasons to consider an investment in the PAC and SL market

 <b>An aging population</b>	 <b>Recovery in the post-COVID</b>
 <b>Increased demand for post-acute environment care following hospital discharges</b>	 <b>Portfolio diversification benefits</b>

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### Post-Acute Care and Senior Living

**Challenges/Headwinds**  
Key obstacles to overcome in the PAC and SL market

 <b>Labor shortages and increasing wage rates</b>	 <b>Low staff vaccine acceptance</b>	 <b>Ongoing PPE and safety protocol-related costs post-COVID</b>	 <b>Repayment of loans and uncertainty regarding future stimulus</b>
 <b>CMS reimbursement policy</b>	 <b>Competitive pricing within senior living to drive occupancy services</b>	 <b>Aged housing inventory</b>	 <b>Transition to home health changes</b>

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## Structure Issues

### OPCO-PROPCO Issues

1. Does Debtor own the land as well as the operations?
2. If Facilities are leased, is rent over or under market?
3. Are leases disguised financing arrangements?
4. Does lessor have blanket liens on all of Debtor's assets?
5. Facilities considered non-residential real property?
  - If residential, then compliance with section 365(d)(3), (4) not necessary?
  - See In re PNW Healthcare Holdings, LLC, et. al., Case No. 19-43754 Dkt. #527 (J. Heston) (leases of skilled residential nursing facilities, are leases of "residential real property")

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## Financing

### Structure of Debtor will also impact financing issues

1. Does Debtor own the "dirt" as well as operations? If so, financing may be easier.
2. Does Lender have a lien on ARs?
3. Is cash collateral sufficient to operate facility?
4. Will a DIP loan be required?

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## “Control” of Deposit Accounts

### 42 U.S.C. 1396a (32)

A State plan for medical assistance must: (32) provide that no payment under the plan for any care or service provided to an individual shall be made to anyone other than such individual or the person or institution providing such care or service, under an assignment or power of attorney or otherwise; except that...

§3488.2 - Payment to Bank. Absent a court order, Medicare payments due a provider of services may be sent to a bank (or similar financial institution) for deposit in the provider's account only if the check is drawn in the name of the provider and the provider certifies that it will continue this payment arrangement only so long as the following requirements are met:

The bank is neither providing financing to the provider nor acting on behalf of another party in connection with the provision of such financing; and the provider has sole control of the account, and the bank is subject only to the provider's instructions regarding the account.

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## “Control” of Deposit Accounts

- (Thus, if the bank is under a standing order from the provider to transfer funds from the provider's account to the account of the financing entity in the same or another bank and the provider rescinds that order, the bank honors this rescission notwithstanding the fact that the rescission breaches the provider's agreement with the financing entity.)
- Use of a Revocable Standing Medicare/Medicaid Deposit Account Service Agreement (Structure often referred to as a “Double Lockbox”), may provide lender some protection while not violating Medicare regs. Such Tri-Party Agreement is entered into among Borrower, Depository Bank and Lender, pursuant to which the Borrower gives Depository Bank revocable instructions to transfer funds received in Borrower's account to Lender on a daily basis.
- What if the Lender is the depository institution? OK, so long as Lender includes waiver of set-off language in Loan Agreement.

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## Working Capital Financing – “Control” of Deposit Accounts

**Does this satisfy §9-104 of the UCC to perfect Lender's security interest in Borrower's deposit account?**

*NO, but it is the best lender can get without violating the anti-assignment regulations.*

**Lender's lien on the A/R remains perfected by the UCC filing, but the practical issue of how to collect A/R is the concern.**

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## Plan Considerations

**Reorganizations are rare given cost structure and unique cash flow problems faced by Debtors. Majority of cases result in a sale.**

### **Plan Issues:**

1. Secured Debt Restructuring: OPCO/PROPCO Structure?
  - Will leases and secured debt need to be/can be restructured?
2. Census: Can census be improved, and Medicare/Medicaid mix be improved to increase cash flow?
3. Is geographic location where operations are located over bedded?
4. Are their regulatory violations which cannot be resolved/fines?
5. Are there Medicare/Medicaid cost report or claw back issues?

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## Plan Considerations

### Recoupment/Setoff – No Stay of Setoff Rights for Medicare Receivables

Currently, there exists a specific exception from the automatic stay relating to Medicare and other federal health care programs in order to allow the Department of Health and Human Services expanded debt collection powers against a health care debtor. Section 362 (b)( 28) of the Bankruptcy Code provides, in pertinent part, that the automatic stay does not apply to the Department's ability to seek setoff during a Chapter 11 case for pre-petition overpayments. Prior to the 2005 amendments to the Bankruptcy Code, setoff rights were subject to the automatic stay whereas recoupment rights were not stayed. Currently, as to the federal government, neither are stayed. Consequently, a debtor must make arrangements to address any reimbursement of prepetition overpayments.

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## Transition/Sale Considerations

### Transfer of Patients to New Facilities (Bankruptcy Code Section 704(A)(12))

- Trustee in cases must use reasonable and best efforts to transfer patients from a failed healthcare business to another healthcare business in the vicinity of the closing healthcare business, that provides the patient with services substantially similar to those provided by the closing healthcare business and that maintains a reasonable quality of patient care
- Costs of patient transfers have administrative priority under Bankruptcy Code Section 507(a)(2) pursuant to Bankruptcy Code Section 503(b)(8)(B)

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## Transition/Sale Considerations

### Operation Transfer Agreement

- Agreement between Seller and Purchaser (may also include old and new management companies as parties) to transfer Debtor's operations. Often used in and out of bankruptcy proceedings.
- Parties agree to cooperate and provide requested documentation necessary for Purchaser to obtain any licenses or approvals
- Seller agrees to remit any proceeds of post-closing accounts receivable to Purchaser or Purchaser's lender

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## Transition/Sale Considerations

### ■ Employees:

- Purchaser typically agrees to offer employment to employees to avoid need to provide notices under the Worker Adjustment and Retraining Notification Act ("WARN Act")
- Purchaser typically indemnifies Seller to the extent there is any liability under the WARN Act or any comparable state law

### ■ Computer Systems:

- May or may not be transferred
- If not transferred, parties should agree to a time period for which Purchaser can use existing computer systems until new computer system is installed and operational

### ■ Indemnity:

- Seller indemnifies Purchaser for any offset or holdbacks for services provided by Seller prior to the closing date or any civil monetary penalties issued for the operations of the facilities prior to the closing date
- Purchaser indemnifies the Seller for any offset or holdbacks for services provided by Purchaser after the closing date or any civil monetary penalties issued for the operations of the facilities after the closing date

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## Transition/Sale Considerations

### Patient Record Disposition (Bankruptcy Code Section 351)

- Governs Healthcare Business Subject To A Chapter 7, 9 Or 11 Proceeding Where The Trustee has Insufficient Funds To Pay For Record Storage
- 365 Day Process Commencing With Publication Of Notice To Patient And Insurance Provider
- First 180 Days - Must Attempt To Notify Each Patient And Its Insurance Carrier By Mail
- Unclaimed Records - Trustee Required To Request Each Federal Agency To Accept Patient Records
- Thereafter Trustee Destroy Records
- Record Disposition Cost Accorded Administrative Priority Under Section 507(a)(2) Pursuant To Bankruptcy Code Section 503(b)(8)(a)

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## Transition/Sale Considerations

1. Are facilities leased or owned? Facilities where “dirt” is owned by the Debtors are easier to finance in a sale.
2. If facilities are leased, can lease defaults be cured?
3. Can proposed buyer satisfy licensing requirements (“CHOW”) and how long will process take?
4. Can Debtor survive until licensing is obtained or will an OTA be required?
5. Will there be sufficient time to market?

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## Chapter 8

# Presentation Slides: The Federal Forfeiture Process

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# The Federal Forfeiture Process

Katie de Villiers

U.S. Attorney's Office, District of Oregon  
Asset Recovery & Money Laundering Division

## Asset Recovery & Money Laundering Division

- ▶ Forfeiture (civil & criminal) & money laundering cases
- ▶ Financial Litigation Program (*primarily restitution collection*)
- ▶ Bankruptcy & foreclosures
- ▶ Affirmative Civil Enforcement cases

## What is Asset Forfeiture?

- ▶ The taking of property
- ▶ By the government
- ▶ Without compensation
- ▶ Because it was used or obtained in a manner contrary to the law.

## Purposes of Asset Forfeiture

- ▶ Punish the criminal
- ▶ Deter illegal activity by taking profit out of crime
- ▶ Remove the tools of the trade
- ▶ Disrupt & dismantle the organization
- ▶ Protect the community
- ▶ Return assets to victims

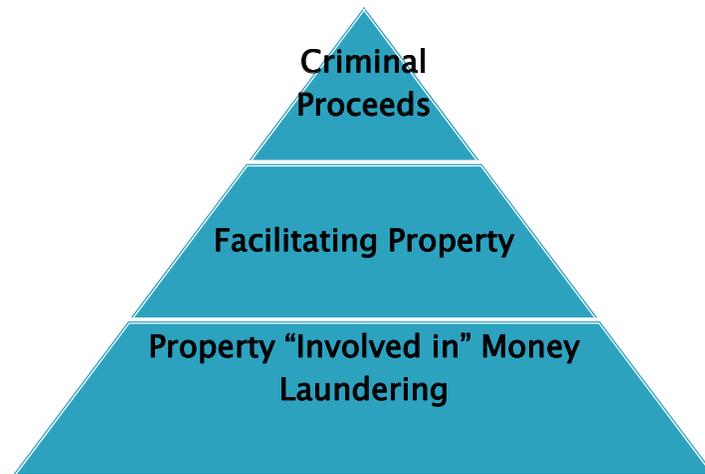
## Property Subject to Forfeiture

Category	Examples
Real Property	House, farm, office park, store, parcel of open space
Tangible Personal Property	Cash, jewelry, art, boat, airplane, car, guns, antiques, electronic equipment
Intangible Personal Property	Professional license, liquor license, website domain name, stocks, lottery winnings, appreciated assets, lien interests, virtual currency

## Statutory Bases for Forfeiture

- ▶ No general forfeiture statute covering all properties and/or crimes
- ▶ Controlled substance offenses
- ▶ Money laundering, mail and wire fraud, other financial crimes
- ▶ Organized crime/racketeering
- ▶ Structuring and other currency reporting violations
- ▶ Crimes listed as “specified unlawful activities”

## What Can We Forfeit?



## 3 Types of Forfeiture Proceedings

- ▶ **Administrative forfeiture**
  - Initiated after seizure by federal agencies
  - If no one claims asset, automatically forfeited
  - Notice phase (18 U.S.C. § 983(a)(1))
    - Direct notice within 60 days of seizure (claim must be filed within 35 days)
    - Publication on [www.forfeiture.gov](http://www.forfeiture.gov) (claim must be filed within 30 days of final publication)
  - Claim phase (18 U.S.C. § 983(a)(2))
    - If a claim is filed, agency forwards to USAO, and we have 90 days to pick one of the remaining 2 options, or else give the property back
- ▶ **Criminal forfeiture**
- ▶ **Civil forfeiture**

## Criminal Forfeiture Highlights

- ▶ Criminal forfeiture is part of the sentence in the criminal case
- ▶ *In personam* action that includes the forfeiture of property in a criminal indictment
- ▶ Can only forfeit defendant's interest; third party claims require ancillary proceeding
- ▶ Cannot reach property of fugitives or deceased persons
- ▶ Can seize substitute assets via a money judgment
- ▶ Federal Rule of Criminal Procedure 32.2 and 21 U.S.C. § 853.

## Money Judgments

- ▶ Primary advantage of criminal forfeiture
- ▶ We can seek this if criminal proceeds have been spent, or if we simply can't find them
  - *"a racketeer who dissipates the profits or proceeds of his racketeering activity on wine, women, and song has profited from crime and therefore must disgorge those funds regardless of whether those funds are still in his possession"* (US v. Newman)

## Substitute Assets

- ▶ Court can order forfeiture of unrelated, untainted assets to satisfy the money judgment against Defendant
  - Inheritance
  - Insurance settlement
  - Real property purchased years before the crime of conviction
  - Earnings following release from prison

## Ancillary Proceedings (i.e., Dealing with 3<sup>rd</sup> Parties in Crim Cases)

- ▶ Essentially civil in nature
  - Civil discovery
  - Motions to dismiss
  - Motions for summary judgment
- ▶ Petitioner has burden of proof by a preponderance – 21 U.S.C. § 853(n)(6)
  - An interest superior to the defendant's
  - A bona fide purchaser for value
- ▶ Who Loses?
  - Nominees
  - General, unsecured creditors

## Civil Forfeiture Highlights

- ▶ *In rem* action against property
- ▶ No criminal charge or conviction required
- ▶ Can reach property of fugitives or deceased Defendants
- ▶ Civil complaint, discovery, rules of procedure all apply
- ▶ Case can (must!) be stayed pending resolution of a related criminal case

## Innocent Owner Defense

- ▶ Claimant's burden to prove by preponderance
- ▶ For property interests at time of illegal conduct:
  - Didn't know of conduct, or
  - After learning of conduct, took reasonable steps to terminate
- ▶ For interests acquired after illegal conduct:
  - Bona fide purchase for value, and
  - No reason to believe property was subject to forfeiture
- ▶ "Owner" excludes:
  - Unsecured creditors
  - Nominees

## Relation back doctrine

- ▶ Right, title, and interest in forfeitable property vests in the United States upon commission of the act giving rise to the forfeiture – 18 U.S.C. § 981(f)

## Forfeiture & Bankruptcy

- ▶ Property subject to forfeiture doesn't become part of the bankruptcy estate
  - Government is not merely a creditor (see Relation Back Doctrine on previous slide)
- ▶ Federal forfeiture proceedings are exempt from automatic stay
- ▶ Forfeiture is not dischargeable in bankruptcy
- ▶ Practical & victim considerations

## Disposition of Forfeited Property

- ▶ Returned to Victims of Crime
  - Remission & restoration processes
  - Attorney General has sole discretion
- ▶ Equitable Sharing Program
- ▶ Destroyed (guns, child pornography material)
- ▶ Deposited into Assets Forfeiture Fund

## Questions?

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## Chapter 9A

# Married . . . But Single: Washington State Issues

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## **MARRIED...BUT SINGLE: WASHINGTON STATE ISSUES**

### **1. Why file bankruptcy separately?**

If a married person files for bankruptcy separately, all of the married person's separate property as well as all of the married couple's community property is included in the bankruptcy estate. As a result, it might make sense to file separately if the non-filing spouse has significant separate property to protect.

In some situations, a spouse may have to file separately regardless of the desire to file a joint petition. For example, if one spouse received a discharge in a Chapter 7 case within the past eight years or in a Chapter 13 case within the past six years, that spouse is ineligible to file a Chapter 7 bankruptcy case within the above referenced time frames. Also, if the spouses are separated and one spouse will not cooperate, there may be no choice but to file separately even if a joint filing would be the better option.

A separate filing may make sense if the married couple married recently, has not acquired any valuable property as a couple and one spouse has significant separate debts. In such a situation, filing separately will allow the spouse who may not be facing debt problems to keep his or her separate property and maintain a good credit rating.

### **2. What is community property?**

Community property is defined in Washington State to be “[p]roperty not acquired or owned, as prescribed in RCW 26.16.010 and 26.16.020 [which defines separate property of a spouse and domestic partner], acquired after marriage or after registration of a state registered domestic partnership by either domestic partner or either husband or wife or both, is community property.”

In Washington, a joinder is required for conveyance of community real property.

R.C.W.A. § 26.16.030. Otherwise, except for certain purposes such as making gifts, either

spouse can manage community property. R.C.W.A. § 26.16.030. *See also In re Ross*, 173 B.R. 937, (Bankr. E.D. Wash. 1994) (improper management of community property business can result in personal liability of managing spouse under Washington law).

The community property states are:

- Arizona;
- California;
- Idaho;
- Louisiana;
- Nevada;
- New Mexico;
- Texas;
- Washington; and
- Wisconsin.

(In Alaska, spouses can sign an agreement making their assets community property, but few people choose to do this.)

### **3. What Happens to Community Property When Only One Spouse Files Bankruptcy?**

#### **a. 11 U.S.C. § 541 Property of the Estate.**

While state law generally defines what constitutes a property interest or a liability, federal law determines how those interests are treated when one spouse files bankruptcy. When a bankruptcy petition is filed, irrespective of whether one or both spouses file bankruptcy, a bankruptcy estate is created pursuant to 11 U.S.C. § 541. The bankruptcy estate includes all property owned by the debtor, interests in property the estate acquires after the commencement of the bankruptcy case, certain property acquired by the debtor within 180 days of filing, certain assets transferred by the debtor before bankruptcy and recovered by the trustee in bankruptcy or by the debtor as debtor in possession, and income on property of the estate.

#### **b. Community Property and the Code.**

The Bankruptcy Code contains specific provisions governing the treatment of community property. Specifically, 11 U.S.C. § 541 (a)(2)(A) and (B) provides for the inclusion of

(2) All interests of the debtor and the debtor’s spouse in community property as of the commencement of the case that is—

(A) under the sole, equal, or joint management and control of the debtor;  
or

(B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor’s spouse, to the extent that such interest is so liable.

This means that as a general rule, all marital community property is included in the bankruptcy estate, irrespective of whether one or both spouses file bankruptcy in accordance with 11 U.S.C. § 541(a)(2)(A).

In addition, the estate includes community property from which a claim against the filing spouse and a claim against both the filing and non-filing spouse can be recovered in accordance with 11 U.S.C. § 541(a)(2)(B). This means that certain assets not under the sole, equal, or joint management and control of the filing spouse are also included in property of the estate and nonetheless available to satisfy certain claims. However, community property assets under the sole management and control of the non-filing spouse may be excluded from property of the estate under § 541(a)(2)(B) if they are exempt under state law and not “liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor’s spouse.”

Finally, any party attempting to prove a spouse’s property is not community property has burden of proof. *In re Cecconi*, 366 B.R. 83 (Bankr. N.D. Cal. 2007). The burden is on the party claiming an asset is separate property and not community property to prove the classification by clear and convincing evidence. *In re McCarron*, 155 B.R. 14 (Bankr. D. Idaho 1993).

**c. Stay of Collection Proceedings.**

Under 11 U.S.C. § 362, there is no co-debtor stay that protects the non-filing spouse from legal action during the pendency of the filing spouse's bankruptcy for a determination of liability for any alleged claim. However, the bankruptcy filing by one spouse results in a stay of all collection proceedings pursuant to 11 U.S.C. § 362(a), including foreclosures, repossessions, and garnishments as to property of the estate, which includes community property, so the breathing spell afforded by a bankruptcy filing by one spouse, including the stay of collection actions actually benefits both spouses.

The exception to the rules above is for the co-debtor stay under 11 U.S.C. § 1301, which provides that actions to commence a civil action for a consumer debt are stayed unless the debt was incurred or secured during the ordinary course of the co-debtor's business or the underlying filing spouse's bankruptcy is closed dismissed or converted.

**d. Can State Court Marital Agreements Affect Community Property in Bankruptcy?**

Parties in bankruptcy, including a bankruptcy trustee, are bound by rights created by state law, including the classification of assets and liabilities by marital property agreements. As a result, what may seem like community property or a community debt can be altered by agreement and is binding in bankruptcy court. *See, e.g., In re Robertson*, 203 F.3d 855 (5th Cir. 2000) (prepetition marital settlement agreement removed community property from debtor's estate under Louisiana law); *In re Kimmel*, 378 B.R. 630 (B.A.P. 9th Cir. 2007) (postpetition agreement changing debtor's income from community to separate property did not create new debt); *In re Hull*, 251 B.R. 726 (B.A.P. 9th Cir. 2000) (case remanded to determine effect of marital agreement and whether chapter 13 debtor had community property interest in spouse's income); *In re Spirtos*, 154 B.R. 550 (B.A.P. 9th Cir. 1993), *aff'd*, 56 F.3d 1007 (9th Cir. 1995)

(applying California law, court found obligations assigned to the debtor under a decree of dissolution created personal liability and a claim against the debtor in his bankruptcy).

**e. Community Claims.**

Under 11 U.S.C. § 101 a community claim means “a claim that arose before the commencement of the case concerning the debtor for which property of the kind specified in section 541(a)(2) of this title is liable, whether or not there is any such property at the time of the commencement of the case.”

Thus, if a creditor has the right under state law to collect its debt from community property defined under 11 U.S.C. § 541(a)(2), the creditor has a community claim and the right to collect from the bankruptcy estate irrespective of whether there are any such community assets. This means that in community property states, a spouse filing bankruptcy without his or her spouse as a joint debtor must give notice to creditors whose community debts were incurred by the non-filing spouse as well as the filing spouse.

**f. Exemptions.**

Section 522(b) only allows an individual filing debtor to exempt property as allowed by state or federal law from property of the estate. The non-filing spouse who is not a bankruptcy debtor cannot claim an asset as exempt. If all of the community property assets are in the filing spouse’s bankruptcy estate, and if the debtor does not claim the community property as exempt, the non-filing spouse has no way to remove the community property from the bankruptcy estate.

This was the case in *In re Homan*, 112 B.R. 356 (9<sup>th</sup> Cir. B.A.P. 1989). In *Homan*, community property included certain real property in Island County, Washington. There were two valid judgment liens recorded against the real property. When one spouse filed bankruptcy, he did not exempt the Island County property under state or federal law, the non-filing spouse sought to exempt the real property under state law. *Id.* at 358.

However, the Court ruled that the inclusion of the real property in the filing spouse's bankruptcy estate "gave him the exclusive right to claim exemptions therein. *Id. citing* 11 U.S.C. § 522(b). The Court noted

[t]he conclusion that [the non-filing spouse] is bound by [the filing spouse's] failure to file a homestead exemption in the Island Property is not subject to modification under the provision of the Bankruptcy Code which permits a nondebtor spouse to declare exemptions as a dependent of a debtor spouse. 11 U.S.C. § 522(a)(1) and § 522(l). Where a debtor files a list of property exemptions claimed under federal law, even an incomplete list, nothing in the language or legislative history of Section 522(l) suggests that nondebtor dependents may supplement this list with state exemptions or further federal exemptions.

*Id.* at 359. The Court further noted that the non-filing spouse was bound by the elections of the filing spouse.

This kind of ruling has significant implications in circumstances where spouses in a community property states are separated, but no divorce decree has entered. *See e.g. Kapila v. Morgan (In re Morgan)*, 286 B.R. 678 (Bankr. E.D. Wis. 2002) (separated spouse filed bankruptcy in *Florida* including community property home where non-filing spouse was living in Wisconsin and opted out of federal exemptions and instead taking Florida exemptions which did not permit exemption of out-of-state property).

One other note of import regarding exemptions. If one spouse files bankruptcy and claims an exemption in community property, the non-filing spouse can claim an exemption in the same property in a subsequent bankruptcy filing. *See In re Bartlett*, 24 B.R. 605 (B.A.P. 9th Cir. 1982) (entire exempt homestead was in both estates, filed at different times, but total exemption was not expanded).

#### 4. Section 524 Community Property Discharge and Community Issues.

##### i. Discharge of a Community Claim.

Under 11 U.S.C. § 524(a)(2), only the filing spouse receives a discharge on the filing spouse’s personal liability. Thus, the discharge for the filing spouse does not affect the non-filing spouse’s personal liability on a “community claim”. Specifically, a discharge under 11 U.S.C. § 524(a)

(2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived . . . .

However, under 11 U.S.C. § 524(a)(3), the discharge protects the community property interests of both the filing spouse and the non-filing spouse from collection of a “community claim”. This is commonly referred to as the “Community Discharge” or “Community Property Discharge”. As a result, “a judgment creditor of the nondebtor spouse on a community claim loses the ability to collect from anything other than the property of the non-filing spouse that is not community property. *Roos v. Kimmel (In re Kimmel)*, 378 B.R. 630, 636 (9th Cir. BAP 2007), *aff’d*, 302 F. App’x 518 (9th Cir. 2008).

Thus, “[r]egardless of whether the community claim was attributable to the actions of the debtor spouse, the nondebtor spouse, or both, the effect of § 524(a)(3) is that all community property acquired post-bankruptcy is protected by the discharge.” *Id.* at 635-36. This further means that the discharge enjoins creditors from collecting on a claim from the post-petition income of both the filing and non-filing spouse. *Willard v. Lockhart-Johnson (In re Lockhart-Johnson)*, 631 B.R. 38, 44-45 (9<sup>th</sup> Cir. B.A.P. 2021).

**ii. Exceptions to the Community Property Discharge.**

Section 524(a)(3) contains two exceptions to the community property discharge. First, the community property discharge does not apply to a community claim that has been excepted from discharge under §§ 523, 1228(a)(1), or 1328(a)(1). This means that the creditor does not need to seek separate relief from the community property discharge or name the non-filing spouse as a defendant in a nondischargeability action when seeking a nondischarge order against the non-filing spouse. *See Case v. Maready (In re Maready)*, 122 B.R. 378, 381-82 (9th Cir. BAP 1991) (holding that plaintiff is not required to allege and prove that a debt is community claim under § 523 or give the innocent spouse notice of the nondischargeability proceeding).

Second, the community property discharge does not apply if the bankruptcy court determines that the claim would be excepted from discharge in a hypothetical case filed by Debtor's spouse on the same petition date. *See* 11 U.S.C. § 523(a)(3).

There are two further exceptions contained in 11 U.S.C. § 524(b). These exceptions rely solely on the actions of a non-filing spouse. Section 524(b)(1) provides that the community property discharge does not apply if the non-filing spouse files a bankruptcy case within six years of the filing spouse's petition and is denied a discharge. If such an order is entered, a creditor with a community claim need do nothing further and the community property discharge is not applicable to community claims. *In re Lockhart-Johnson*, 631 B.R. at 46.

The second exception is found in section 524(b)(2), which provides that the community property discharge does not apply if the bankruptcy court determines that it would not grant a discharge to the nondebtor spouse in a hypothetical case filed on the same petition date. This is the same exception as is found in section 524(a)(3).

The Bankruptcy Code does not address how to initiate these hypothetical cases, but the Ninth Circuit Bankruptcy Appellate Panel has ruled that

hypothetical nondischargeability based on a nondebtor's conduct must be "determined in accordance with the provisions of §§ 523(c) and 523(d)." Section 523(c) requires creditors with notice of the case to affirmatively seek a nondischargeability determination of claims asserted under §§ 523(a)(2), (4) or (6), or have those claims discharged. And Rule 4007(c) provides that a complaint under § 523(c) must be filed within 60 days of the meeting of creditors.

*Id.* at 46-47. *See also In re Strickland*, 153 B.R. 909, 912 (Bankr. D.N.M. 1993) ("It is the duty of scheduled creditors to object to the hypothetical discharge of the nondebtor spouse, within the time limits set by the bankruptcy code.").

The community property discharge has a further limitation. The community property discharge only applies so long as a marital community continues to exist. *Heilman v. Heilman* (*In re Heilman*), 430 B.R. 213, 219 (9th Cir. BAP 2010) (*citing In re Kimmel*, 378 B.R. at 636).

**iii. Consequence of Obtaining a Discharge Judgment in a Community Property State.**

If creditor obtains a nondischargeability judgment in a filing spouse's bankruptcy, the debt is not only excepted from discharge, but both spouses' interests in community property are subject to collection action and the couple's community assets are available for recovery under state law notwithstanding the bankruptcy. *In re Hibbs*, 161 B.R. 259 (Bankr. C.D. Cal. 1993).

**iv. Can a Creditor Holding a Community Claim Seek a Non-Discharge Judgment Against an Innocent Filing Spouse?**

In the recent case of *Lockhart-Johnson*, 631 B.R. at 38, the Court examined whether a creditor could seek a non-discharge judgment against a spouse for the fraudulent conduct of the non-filing spouse. The creditor had obtained a state court judgment against the non-filing spouse arising from a contract for home repairs. The creditor filed a complaint within 60 days of the filing spouse's 341 meeting seeking to except the judgment from discharge under 11 U.S.C. § 523(a)(2)(A) based on the non-filing spouse's conduct. However, the creditor did not set forth any allegations of fraudulent conduct in the complaint by the filing spouse and the creditor failed

to allege that the debt was a community claim. The Bankruptcy Court denied the creditor's request for leave to amend and dismissed the complaint.

The Bankruptcy Appellate Panel did not rule on the merits, but did find that the creditor had filed the complaint within sufficient time to amend the complaint with the key issue being whether the debt the creditor sought to be subject to a nondischarge order was a community claim that could relate back to the date of the original complaint filing date. The Court thus remanded the matter to permit the creditor to amend the complaint and allow the Court to rule on the issue of a community claim and relation back.

**Key Takeaway. Make sure to file the complaint within 60 days of the 341 meeting of creditors and plead facts sufficient to support a community claim.**

#### **5. Liquidation of Community Property by a Trustee.**

To the extent a bankruptcy estate contains non-exempt community property, a Chapter 7 or Chapter 13 trustee may liquidate such asset. In other words, “[a]ny nonexempt community property would be liquidated and distributed, and all that passes out of the estate is exempt community property.” This is logical: the discharge injunction would not protect the debtor (or nonfiling spouse) from the Chapter 7 trustee's liquidation of non-exempt estate property.” *In re Nelson*, 308 B.R. 343, 346 (Bankr.E.D.Wis. 2004) quoting *In re Schmiedel*, 236 B.R. 393, 398 (Bankr.E.D.Wis. 1999). See also *In re Pruitt*, 2011 Bankr.D.Or. LEXIS 2219, 2011 WL 2292205

Moreover, if there is liquidation value in community property after the application of the filing spouse's exemption claims, the Trustee may liquidate the community property, pay the filing spouse the value of the exemption claim and make a distribution to creditors from the proceeds of the community property. See *In re Victor*, 341 B.R. 775, 782 (Bankr. D.N.M. 2006).

Finally, liens can be stripped from community property because 100% of the property interest is property of the estate, which may permit a trustee to liquidate property it might not

otherwise be able to liquidate. *See e.g. In re Maynard*, 264 B.R. 209, 214 (B.A.P. 9th Cir. 2001) (section 506 could be used to strip off a lien because both halves of a community property asset was property of the debtor's bankruptcy estate, even though only one spouse filed bankruptcy).

## 6. Distribution of Community Property.

Section 726(c) establishes the protocols for distribution of community property as defined in section 726(a)(2) and/or the proceeds of such property in a chapter 7 case as well as any other property not defined as community property. Section 726(c) requires that community property be separated from other property of the estate and distributed in the order enumerated in subsections (c)(1) and (c)(2).

Under 11 U.S.C. § 726 (c)(1), the first distributions from community property are paid on administrative claims as defined in 11 U.S.C. § 503.

Under § 726(c)(2), the subsequent distributions from all of the bankruptcy assets available to pay claims are paid in accordance with the distribution order set out in 11 U.S.C.

§ 726(a). The types of property used to satisfy those claims are distributed in the following order:

- i. **Community Property Generally.** Community claims against either the debtor or nondebtor spouse **are** paid from any community property except to the extent such property is solely liable for the debts of the debtor.
- ii. **Community Property; Special Liability.** Any community claims not satisfied under the previous distribution are paid from community property that is solely liable for the debts of the debtor.
- iii. **Separate and Other Property.** Any remaining community claims, and all other claims against the debtor, are paid from the debtor's non-community property.
- iv. **Any Remaining Property.** Any community claims against the debtor or debtor's spouse still remaining are satisfied with whatever property remains in the estate.

These distribution rules are applicable to reorganization cases under chapters 11, 12, and 13 for determining whether the best interests of the creditors are met by the proposed plan. See §§ 1129(a)(7), 1225(a)(4), 1325(a)(4).

**7. What happens to community property when one spouse files first and then the second spouse files?**

If spouses file overlapping bankruptcy cases, one before the other, all community property assets become property of the estate of the first spouse to file, and remain property of such bankruptcy estate until they cease to be property of that estate in accordance with 11 U.S.C. § 544(c), at which time the community property assets become property of the estate of the second spouse to file bankruptcy, if such second case is still pending at that time.

**8. Chapter 13 issues**

When a married person does not file a joint chapter 13 bankruptcy case with their spouse, the income and expenses of the non-filing party is nevertheless considered in determining how much the filing spouse has to pay per month to a Chapter 13 trustee and for how long.

This was not always the case prior to the Bankruptcy Abuse Prevention and Consumer Protection Act enacted October 17, 2005 (“BAPCPA”). Prior BAPCPA, a person filing for Chapter 13 bankruptcy was only required to submit his or her income and expenses as well as all of the debts. After the law change, the non-filing spouse or the total household income of the parties became the standard by which chapter 13 cases were governed.

This can greatly affect the amount that the filing spouse must pay to a Chapter 13 trustee and in some cases could put the filing spouse over the limit of what they can actually afford to pay on a Chapter 13 plan from the filing spouse’s income.

For example, consider a potential filing spouse has a monthly income of \$4,000.

However, the non-filing spouse has monthly income of \$6,000. The total household monthly

income of \$10,000 is considered in what the marital community should be supposedly contributing to both parties debts even where the debts are solely in the name of the filing spouse. The good news is that in undertaking the calculation, the filing spouse can also use the non-filing spouse's monthly expenses to offset some of the income. As a result, monthly payments for the non-filing spouse such as a car and insurance payments, credit cards and monthly spousal and/or child support payments to an ex-spouse could all be used to offset the total marital community monthly income.



## Chapter 9B

# Married . . . But Single: Oregon State Issues

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### **Why not file separately?**

#### Family expense statute – ORS 108.040

(1) (a) The expenses of the family and the education of the minor children are chargeable upon the property of both spouses in a marriage who are parents of the minor children, or either of them, and in relation thereto they may be sued jointly or separately.

(b) As used in this subsection:

(A) “Expenses of the family” includes only expenses incurred for the benefit of a member of the family.

(B) “Family” means the spouses in a marriage and the minor children of the spouses.

There are similar provisions relating to stepparent (108.045) and exceptions related to separation of the spouses (108.040(2 and 3)).

Client should be advised of potential increased cost for subsequent bankruptcy if spouse is pursued by creditors for family expenses?

#### Potential Credit Issue

Potential need for future joint credit

For many households, the non-filing spouse’s income is still factored into bankruptcy calculations for household income. Potential goal of “keeping spouse out of this” is not necessarily met.

### **Why file separately?**

Preserve spouse’s credit

Spouse’s separate assets, inheritance, etc.

#### Tenancy by Entirety

What is it?

“Interest in entireties is in the nature of a tenancy in common with right of survivorship.” In re Odegaard, 31 B.R. 718, 721 (Bankr. Or. 1983)

“treated as a tenancy in common with an indestructible right of survivorship.” Brownley v. Lincoln County, 343 P.2d 529, 531 (Or. 1959).

“Cotenants holding concurrent life estates with contingent remainders.” Hilterbrand v. Carter, 27 P.3d 1086, 1089 (Or. App. 2001)

How created?

ORS 93.180

- (1) A conveyance or devise of real property, or an interest in real property, that is made to two or more persons:
  - (a) Creates a tenancy in common unless the conveyance or devise clearly and expressly declares that the grantees or devisees take the real property with right of survivorship.
  - (b) Creates a tenancy by the entirety if the conveyance or devise is to spouses married to each other unless the conveyance or devise clearly and expressly declares otherwise.**

What it means for the spouses

1. The right of survivorship cannot be cancelled unilaterally by one cotenant against the other. Halleck v Halleck et al, 216 Or. 23, 40-41, 337 P.2d 330 (1959) (“Th[e] contingent remainder which each co-tenant has cannot be defeated by any act of his co-tenant.”)
2. The interest of one cotenant “can be alienated by deed or by sale on execution.” In re Odegaard, 31 B.R. 718, 719 (Bankr. Or. 19893). “The transfer of the interest of one tenant however does not terminate the tenancy nor does it in any way affect the interest of the non-debtor spouse.” Id.

What it means for creditors.

Creditors obtaining a judgment take over the right of survivorship of the judgment debtor and, if applicable, the right to one-half of the rents and profits from the property during the remainder of the tenancy. Cf. Odegaard at 719.

Creditor execution sale

Judgment creditors can seek an execution sale of the property, but court must consider the interests of all parties, including non-debtor spouse. ORS 105.315

Tax liens – The IRS lien can attach to debtor’s interest in TBE property. The IRS has the right to sell the entire property, subject to payment to the nontaxpayer spouse for the fair value of their interest. See, In re Pletz, 225 B.R. 206, 209 (Bankr. Or. 1997) (discussing United States v. Rodgers, 461 U.S. 677, 103 S. Ct. 2132, 76 L.Ed.2d 236 (1983)).

### What it means in bankruptcy

TBE property interests may be exempted from property of the estate “to the extent that such interest is exempt from process under applicable nonbankruptcy law.” 11 U.S.C §522(b)(3)(B). Cf. In re Cataldo, 224 B.R. 426 (B.A.P. 9<sup>th</sup> Cir. 1998) (under Hawaiian law creditor may not levy against TBE property for separate debts of either spouse without consent of by spouses).

### Impact on lien avoidance

In calculating voidability of lien must calculate debtor’s interest in TBE property. Because this involves the survivorship interests of both the debtor and the nondebtor spouse this must be calculated with reference to each of their actuarial interests. For detailed discussions of this, see In re Odegaard, 31 B.R. 718 (Bankr. Or. 1983); In re Pletz, 225 B.R. 206 (Bankr. Or. 1997); and In re Pletz, 221 F.3d 1114 (9<sup>th</sup> Cir. 2000).

### Impact on trustee sale

11 U.S.C. §363(h) allows for sale of the entireties property only if –

- (1) Partition in kind of such property among the estate and such co-owners is impracticable;
- (2) Sale of the estate’s undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of such co-owners;
- (3) The benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and
- (4) Such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.

So a 363(h) sale requires balancing of the cotenants interests (occupancy, rents and profits, survivorship) just as ORS 105.315 would.

Question: How does existence of solar panels generating surplus power impact 363(h) analysis? Cf. Net Metering Law.

### What it doesn’t mean

Mortgage debt held by entireties is not an escape hatch to non-consumer case classification. In re Campayno, Memorandum Opinion, 21-22319 (W.D. PA 4/27/22)

