A Review of Ninth Circuit Bankruptcy Decisions (2010)

A BROADCAST FROM THE FEDERAL JUDICIAL CENTER

A *Discussion of Particularly Significant Bankruptcy Cases Decided by the Supreme Court, the Ninth Circuit Court of Appeals, and the Ninth Circuit Bankruptcy Appellate Panel in 2010*

Presented by

Ninth Circuit Bankruptcy Judges Education Committee

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Milavetz, Gallop & Milavetz, P.A. v. United States, 130 S. Ct. 1324 (2010)

Summary of Issue and Holding

The Supreme Court addressed the issue of whether attorneys are "debt relief agencies" and, if so, whether the requirements under the Bankruptcy Code governing advice to clients and disclosures on advertising violate the First Amendment rights of attorneys.

Facts

Attorneys challenged the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) requiring that debt relief agencies not advise consumers to incur new debt in contemplation of filing bankruptcy and to include in advertisements that services offered include filing bankruptcy. Attorneys also claimed that BAPCPA did not include attorneys as "debt relief agencies," and, if attorneys were included, the provisions were unconstitutional because they violated the First Amendment. The Supreme Court determined that under the plain language of BAPCPA, Congress included attorneys as debt relief agencies. Further, that the limitations were not overbroad and did not violate the First Amendment. The limitations only precluded debt relief agencies from advising consumer debtors to incur, for improper purposes, debt in contemplation of bankruptcy, and the limitations did not prohibit attorneys from discussing the legal issues relating to incurring such debt. The Court also determined that requiring a debt relief agency to expressly state that its services include filing bankruptcy did not violate the First Amendment, as such a disclosure did not prevent the debt relief agency from disclosing other information in its advertisement.

Holding

Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 to correct perceived abuses in the bankruptcy system. The BAPCPA includes a number of provisions governing the conduct of bankruptcy professionals defined to be "debt relief agencies." The term "debt relief agency" includes any person who, in return for payment, provides a person who has primarily consumer debts with information, advice, or counsel; assists with document preparation or filing; attends a creditors' meeting; or provides or appears as legal representation in connection with a bankruptcy case or proceeding.

At issue before the Supreme Court were restrictions on a debt relief agency to not advise the consumer debtor to incur more debt, either in contemplation of filing bankruptcy or to pay an attorney or bankruptcy petition preparer for services in preparing for or representing a debtor in a bankruptcy case. Further, a debt relief agency, in advertisements directed to the general public, must clearly and conspicuously disclose that the bankruptcy services or the benefits of bankruptcy being advertised are relief under Title 11, and advertisements must include a specific statement that the debt relief agency helps people file for relief under the Bankruptcy Code. These disclosures were required to ensure that consumers dealing with debt relief agencies understood that bankruptcy services were being offered, and not merely debt counseling or nonbankruptcy debt repayment plans.

From a plain reading of what the Supreme Court found to be the unambiguous language of the statute, the Court concluded that Congress intended attorneys to be included in the definition of a debt relief agency. The Court also referenced, though it concluded it to be unnecessary, the legislative history of this amendment and congressional concern over abusive practices undertaken by attorneys. The Supreme Court was not moved by Milavetz's argument that such congressional action would interfere with the state's authority to determine and enforce qualifications for the practice of law. Congress and the bankruptcy courts have long overseen aspects of attorney conduct in this area of substantial federal concern.

Milavetz also attacked the constitutionality of this provision as being an overbroad, content-based restriction on attorney–client communication not adequately tailored to constrain only the speech that the government has a substantial interest in restricting. It was argued that the statute prohibiting an attorney from advising a consumer to incur more debt in contemplation of filing for bankruptcy or paying the attorney for services in preparing for the bankruptcy filing also prohibited the attorney from providing beneficial advice that could help the consumer avoid filing bankruptcy (such as a refinance or loan restructure that would require the consumer to take on new debt to make the repayment of the existing debt more affordable). Further, Milavetz asserted that this section prohibited the attorney from even discussing the advantages, disadvantages, and legality of the consumer incurring additional debt.

The Supreme Court rejected such a broad reading of this remedial section and concluded that this section only limits the attorney from adversely manipulating the bankruptcy system. A debt relief agency, including attorneys, is only prohibited from advising a consumer debtor to incur more debt because the debtor is filing for bankruptcy, rather than for a valid purpose. Even if the trial court were to conclude that the new debt was made in contemplation of the bankruptcy filing, the court must determine whether incurring the debt was reasonable. This section targets consumer debtors who would load up on debt prior to filing a bankruptcy case. There is no prohibition on an attorney discussing the legality of incurring such debt, only on advising the consumer client to incur such debt.

The Supreme Court determined that the scope of the statute prohibiting advice to incur debt in contemplation of a bankruptcy filing does not violate the First Amendment as impermissibly vague (the only grounds for the First Amendment challenge). The Court also rejected the contention that the advertising disclosure requirement violated the First Amendment. The disclosure requirements only required that the advertisement contain accurate information and not mislead the consumer. The Court held that the disclosure requirement must directly advance a substantial governmental interest, with the regulation being no more of an extensive intrusion on commercial speech than necessary to serve that interest. Requiring a disclosure in the advertisement that includes bankruptcy filing as one of the services provided does not prevent an attorney from conveying any additional information to his or her client.

Ransom v. FIA Card Services, 131 S. Ct. 716 (2011)

Facts

At the time of his Chapter 13 filing, the debtor owned a Toyota Camry free and clear of liens. As an above-median debtor, the means test required him to calculate his expenses based on the IRS National and Local Standards. The debtor claimed an "ownership cost" deduction of $471. FIA Card Services objected to plan confirmation on the grounds that the debtor was not committing all of his disposable income to unsecured creditors, arguing that he should not have claimed the ownership cost deduction because he did not make a loan or lease payment on the car. The bankruptcy court denied confirmation and was upheld by the Ninth Circuit BAP and the Ninth Circuit.

Issues

May an above-median Chapter 13 debtor who owns a vehicle free and clear claim the ownership costs expense in calculating projected disposable income?

Holding

The Supreme Court held that an above-median Chapter 13 debtor who does not have a vehicle loan or lease payment may not take the "ownership costs" deduction for that vehicle when calculating his or her disposable income. The Supreme Court determined that the Bankruptcy Code permits debtors to claim only "applicable" expenses, and, since the debtor owned his Camry free and clear, the ownership costs deduction was not applicable to his situation. Justice Kagan, writing for the majority, noted that since Congress intended the means test to capture a debtor's reasonable expenditures, if a debtor will not have a particular kind of expense, an allowance to cover that kind of cost is not "reasonably necessary" for that debtor.

The Court held that a debtor may claim an expense only for the specified sum in the tables for ownership expenses, even if the debtor's actual ownership expense (loan or lease payment) exceeds the amount in the tables. The Court declined to resolve the issue of the proper deduction for a debtor whose vehicle ownership expenses are less than the amounts listed in the Local Standards. Regarding the argument that this interpretation produced an anomaly where a debtor with one remaining payment owed on a car loan or lease payment might obtain a full ownership cost deduction, the Court noted that this problem can be addressed by moving to modify the plan to increase the amount the debtor must pay.

Ahcom Ltd. v. Hendrik Smeding, et al., 623 F.3d 1248 (9th Cir. 2010)

Summary of Issue and Holding

The Ninth Circuit Court of Appeals addressed the issue of whether a creditor of a debtor corporation could assert claims directly against principals of the debtor corporation on an alter ego theory, or whether the bankruptcy trustee was the sole party who could assert such claims against the principals of the debtor corporation. The Ninth Circuit clarified that no "freestanding general alter ego claim" exists under California law; that the bankruptcy trustee cannot bring a claim against principals as alter egos for all of the corporate debts; and that the creditor could advance its claims for the obligation owed by the corporation against the principals of the corporation on an alter ego theory.

Facts

Ahcom, Ltd. obtained an arbitration award against Nuttery Farms, Inc. (NFI). Upon obtaining the arbitration award, Ahcom sued in California state court to collect the award. Ahcom did not sue NFI, but sued its sole owners, asserting that based on the principles of alter ego, Ahcom could pierce the corporate veil and collect the award against the owners. The state court complaint alleged that the owners controlled, dominated, and operated NFI as their individual business, diverted funds and assets of NFI for other than corporate uses, treated the NFI assets as their own, and diverted NFI assets to themselves to the detriment of creditors, including Ahcom. The owners removed the state court action to the federal court where the NFI bankruptcy proceedings were being conducted. The owners contended that the Ahcom complaint claimed that the alleged conduct harmed all creditors, and, as such, the claim was exclusively property of the estate, which only the bankruptcy trustee could prosecute. The district court agreed and granted the owners' motion to dismiss the complaint without leave to amend.

Holding

The Ninth Circuit Court of Appeals first considered what constitutes a claim of alter ego under the applicable state law of California. The alter ego doctrine exists not to establish, for all purposes, whether the corporation is an alter ego of its shareholders or officers, but only whether the organization of the corporation works to defraud the individual asserting the claim. It is for the court to determine under the particular case presented and for the purposes of that case whether justice and equity can best be achieved and fraud and unfairness defeated by disregarding the corporate form. An "alter ego" claim is not for substantive relief, such as a breach of contract, or to set aside a fraudulent conveyance, but is a procedural claim relating to the enforcement of substantive rights. The Ninth Circuit disapproved an earlier ruling by a bankruptcy court and the Bankruptcy Appellate Panel, which held that California law allowed a corporation (and its bankruptcy trustee) to bring a general alter ego claim against its owners.

The Chapter 11 trustee in the NFI bankruptcy case has a special role, standing in the shoes of the debtor corporation and has standing to bring any suit that the corporation could have brought had the corporation not filed bankruptcy. This standing of the trustee to bring suits on behalf of the corporation is exclusive and divests all creditors of the power to bring such suits. However, the trustee is limited only to those claims that could have been brought by the corporation, and the trustee's standing does not divest creditors of the right to sue third parties on behalf of creditors of the corporation.

In this case, Ahcom asserted that it had the right to be paid by the owners for an arbitration award that it obtained against NFI. Ahcom was not attempting to assert any rights of NFI (property of the bankruptcy estate) or any claims that the bankruptcy trustee could assert against the owners. The trustee may bring claims for the corporation against the owners for fraudulent conveyances, conversion, theft, and breach of fiduciary duty, among other claims, under California law or the Bankruptcy Code. But the trustee cannot bring Ahcom's claim for the obligation owed by NFI, nor can it bring Ahcom's contention that NFI should be deemed the alter ego of the owners.

JTS Corp. v. Jack Tramiel, et al. (*In re* JTS Corp.), 617 F.3d 1102 (9th Cir. 2010)

Facts

Jack Tramiel, a director of debtor JTS Corporation, purchased eight parcels of real property from JTS for $10 million with a one-year buy-back option in an effort to help JTS obtain funds to continue operating. The JTS board (excluding Tramiel, who removed himself from all discussions of the deal), believed that the purchase was necessary to keep JTS afloat and that the price was fair in light of the circumstances. The sale closed in September 1996, but JTS was not able to sustain itself and filed a Chapter 11 bankruptcy petition in November 1998. The case was converted to Chapter 7 in 1999.

The trustee filed a complaint against JTS's directors (including Tramiel), attorneys, and a shareholder alleging fraudulent conveyance and other claims. Tramiel's codefendants settled with the trustee for $4.5 million. The bankruptcy court found the sale of real property to be a fraudulent conveyance under 11 U.S.C. § 544(b) and

California Civil Code 3439.04. The bankruptcy court found the fair market value of the parcels of property to be $15,760,000, but reduced the reasonably equivalent value to $11,820,000 because the property was bundled and it was a quick sale. The court valued the repurchase option at $432,815. The court held that Tramiel was a good-faith transferee and offset from the trustee's recovery the amount Tramiel paid for the property, plus the value of the option, for a total offset of $10,432,815, and a liability for Tramiel of $1,387,185. However, the bankruptcy court also determined that Tramiel could offset the judgment by the amount paid by his codefendants pursuant to California Code of Civil Procedure ("CCP") 877. Because the settlement amount exceeded Tramiel's liability, he owed nothing to the estate.

On appeal, the district court held that the purchase was a fraudulent conveyance, but it found the reasonably equivalent value for the property was its fair market value, or $17,147,185. The district court agreed that Tramiel was entitled to a $10,432,815 offset as a good-faith purchaser, but that he was not entitled to offset any amount paid by the codefendants in the settlement. Thus, Tramiel's liability to the estate was $6,714,370.

Issues

1. What is the reasonably equivalent value for the real property?
2. Is a board of directors allowed to offset any amount paid as a good-faith transferee?
3. Is a defendant entitled to a credit for the amount paid by his codefendants in a settlement agreement?

Holding

Value of real property

The appeals court found that the district court erred in finding the fair market value of the property to be $17,147,185, because the bankruptcy court's finding was not clearly erroneous. The bankruptcy court examined all relevant testimony, reasonably determined the fair market value of the property, and reduced it accordingly to reach the reasonably equivalent value.

Good-faith transferee

The district court and bankruptcy court correctly reduced the trustee's recovery by the amount Tramiel paid as a good-faith transferee. The trustee argued that the bankruptcy and district courts erred in finding Tramiel as a good-faith transferee under California Civil Code 3439.08(d)(3) because 11 U.S.C. §§ 544(b) and 550(a) only are subject to laws that determine voidability. The Ninth Circuit held that in order to abide by the intent established in 11 U.S.C. § 550(b) (to promote and restore the estate to its prior condition), the good-faith exception applies and allows for a reduction in a trustee's recovery. *In re JTS Corp.,* 617 F.3d 1102 (9th Cir. 2010).

Settlement credit

The bankruptcy court was correct to offset the amount paid by the codefendants from the amount Tramiel owed to the estate. Individuals may offset their judgment by any amount paid by joint tortfeasors under CCP § 877. To be a joint tortfeasor, the individuals must have caused "one indivisible injury" or "the same wrong." Here, Tramiel and the settling codefendants caused the same injury, the fraudulent transfer. The bankruptcy court was correct in finding Tramiel and the codefendants to be joint tortfeasors and properly offset the amount paid by the codefendants.

AmeriCredit Financial Services, Inc. v. Marlene A. Penrod, 611 F.3d 1158 (9th Cir. 2010), *rehearing en banc denied,* 2011 U.S. App. LEXIS 3798

Summary of Issue and Holding

The court had to determine what portion of a secured auto loan for a vehicle purchased within 910 days of the commencement of a Chapter 13 case was entitled to purchase money security interest status and exempt from being bifurcated into an unsecured claim pursuant to 11 U.S.C. § 506(a). The auto loan included monies to pay off the negative equity in a trade-in vehicle (the amount that the loan on trade-in exceeded the value of the trade-in), and the creditor argued that the negative equity was entitled to purchase money security interest status under the Bankruptcy Code. The court concluded that purchase money security interest status exists only for the price of the vehicle purchased and does not include credit extended to pay the negative equity in a trade-in vehicle. The Chapter 13 debtor's negative equity portion of the loan was determined to be an unsecured claim in the bankruptcy case to the extent that there was no value in the collateral for that portion of the lien.

Facts

Penrod (the debtor) purchased a Ford Taurus in September 2005 for $25,600, trading in her existing vehicle. The loan secured by the trade-in vehicle was $7,000 greater than the value of the Taurus. This $7,000 of "negative equity" was added to the loan for the purchase of the Taurus, for a new loan of $31,700. Five hundred twenty-three days later Penrod filed a Chapter 13 bankruptcy case, and sought to bifurcate the Taurus loan as a secured claim for the portion of the loan balance that related to the $25,600 purchase price of the Taurus and the balance for the portion relating to the $7,000 negative equity in the trade-in vehicle as a general unsecured claim. Because the Taurus was purchased within 910 days of the commencement of the Chapter 13 case, the purchase money security interest held by the creditor could not be bifurcated into a secured and an unsecured claim pursuant to 11 U.S.C. § 510(a). The Ninth Circuit determined that the purchase money security interest that could not be bifurcated is only for the purchase price portion of the Taurus and the balance of the loan was subject to classification as a general unsecured claim.

Holding

The Ninth Circuit began its analysis with the statement that it recognized that eight other circuits have addressed this issue and have concluded that the entire loan balance (new car purchase price and rolled over negative equity) is given purchase money security interest protections in Chapter 13 cases. This provision was added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). This provision is commonly called the 11 U.S.C. § 1325(a) "hanging paragraph," because it was added to the end of § 1325 without a paragraph number. This hanging paragraph precludes § 506(a) bifurcation of a creditor's claim into a secured claim (to the extent of the value of the creditor's interest in the collateral) and an unsecured claim for the balance of a purchase money security interest for an obligation for purchasing a vehicle within 910 days of the commencement of a bankruptcy case, or for any other purchase money security interest if the debt was incurred within one year of the commencement of the bankruptcy case.

The term "purchase money security interest" is not defined by the Bankruptcy Code. Under Division 9 of the California Commercial Code, a purchase money security interest exists to the extent that the goods purchased secure an obligation for all or part of the price for such goods. A purchase money security interest is granted senior priority rights over other types of security interests and liens. To correctly apply the provisions of the § 1325(a) hanging paragraph, the court must correctly determine the "price" for the goods purchased. AmeriCredit argued that the "price" for the Taurus included all of the expenses in acquiring that car, including the negative equity that had to be paid. This argument was rejected by the Ninth Circuit.

Though surveys presented to the court indicated that over one-third of all vehicles purchased in the United States include a negative equity trade-in, that does not mean that the negative equity is part of the purchase price for the purchase money security interest. Negative equity is not of the same nature as the other transaction costs necessary to complete the purchase money transaction, such as sales tax, duties, and finance charges. The negative equity component is typically larger and readily separable from the purchase transaction itself.

The Ninth Circuit also rejected the contention that the California Automobile Sales Finance Act (ASFA) provides that negative equity is part of the purchase money security interest. ASFA includes negative equity charges in the "cash price" of a vehicle, which must be disclosed to the consumer purchaser. The Ninth Circuit determined that the "cash price" disclosure is meant to clearly inform the consumer that he or she is responsible for paying the negative equity. This is a consumer protection disclosure statute rather than a statute defining a purchase money security interest.

The court also found that AmeriCredit's arguments were not consistent with the Bankruptcy Code. In considering the new value affirmative defense to a preference action, 11 U.S.C. § 547(c)(3), the Bankruptcy Code defines new value to be money or money's worth in goods, services, or new credit, and not for old obligations that are repackaged. The courts must focus on the price of the new goods purchased, not on other debt that is refinanced to facilitate the purchase of the goods. A purchase money security interest exists only for the price of the goods purchased.

The Ninth Circuit panel expressly did not address the issue of whether it is proper to create dual status liens, one that is a purchase money security interest and one that is a non-purchase money security interest. While acknowledging that decisions creating dual status liens for auto loans have been the subject of criticism in scholarly commentary, that issue was not appealed by AmeriCredit.

Sternberg v. Johnston, 582 F.3d 1114 (9th Cir. 2009), *as amended by* 595 F.3d 937 (2010)

Facts

After debtor (Johnston) filed a Chapter 11 petition, a state court issued a minute order finding Johnston in contempt for non-payment of spousal support and ordering the support be paid in full or debtor be jailed. Debtor filed an appeal with the state court of appeals and also sought relief from the bankruptcy court, both by motion and by initiating an adversary proceeding. Opposing counsel Sternberg filed a brief in the court of appeals defending the order in full. The bankruptcy court found the minute order violated the stay and vacated it. After the adversary proceeding went to trial, the bankruptcy court initially found no willful stay violation. The district court reversed, concluding Sternberg had willfully violated the stay, and remanded. On remand, the bankruptcy court awarded debtor his attorney fees and costs for prosecution of the adversary proceeding, in addition to other damages.

The Ninth Circuit issued its original decision in October 2009, affirming the finding that a willful stay violation had occurred but vacating the award of attorney fees related to the adversary proceeding. The court held that once the debtor filed bankruptcy, Sternberg had an affirmative duty to conform his conduct to the automatic stay. The duty went beyond just stopping any collection effort, as in the *Eskanos* case; the duty also required that Sternberg take affirmative action to stay or vacate the state court's order.

The court agreed with Sternberg, though, that debtor should not have been awarded fees for prosecution of the adversary proceeding—the debtor should only have been awarded fees that arose from the work associated with remedying the stay violation. Once the violation has ended, any fees the debtor incurs after that point in pursuit of a damage award are not "actual damages" under § 362(k)(1) and fall under the American Rule that a plaintiff ordinarily cannot recover fees spent to correct his or her legal injury. Permitting a debtor to collect fees for prosecuting a damages action did not further the goal of the automatic stay, which is intended to be a shield not a sword.

Issue

Does the holding preclude a party from recovering attorney fees in a civil contempt action?

Holding

The second part of the court's decision was the subject of a February 2010 amendment to § 362(k)(1): a new footnote was added to the discussion of damages available under § 362(k)(1). The new footnote noted that the court's decision that attorney fees were not available was based solely on the authority of § 362(k)(1). As the court did not consider its civil contempt authority, it did not limit the availability of contempt sanctions, including attorney fees, for violation of the automatic stay, where otherwise appropriate. With the amended footnote, the court denied a petition for panel rehearing and for rehearing en banc.

Chase Manhattan Bank, USA v. Harold S. Taxel, Trustee, 594 F.3d 1073 (9th Cir.), *cert. denied,* 131 S. Ct. 85 (2010)

Summary of Issue and Holding

The court considered whether the listing of a creditor as having a secured claim in the bankruptcy schedules filed by a debtor in a voluntary bankruptcy case provided notice to defeat the trustee's standing as a hypothetical purchaser for value of real property of the bankruptcy estate. The Ninth Circuit Court of Appeals concluded that the debtor's schedules in a voluntary bankruptcy case do not provide such notice and that the trustee's interest in the property of the estate prevails over a creditor holding an unrecorded deed of trust.

Facts

In this case, the debtors refinanced their condominium several times, with the last two refinances being provided by Chase Bank. Upon completion of the last refinance, Chase Bank reconveyed the deed of trust, which secured the existing debt, but failed to record the deed of trust, which secured the new loan. The debtors filed bankruptcy in 2004, and on their schedules listed Chase Bank as having a claim secured by the condominium. The Chapter 7 trustee filed an action under Bankruptcy

Code § 544, asserting his status as a bona fide purchaser of real property from the debtor, irrespective of any actual knowledge of an interest in the condominium. 11 U.S.C. § 544(a)(3). The Chapter 7 trustee contended that as a bona fide purchaser under § 544(a)(3), the interests of the bankruptcy estate were superior to that of Chase Bank for the unrecorded deed of trust.

Holding

The Ninth Circuit Court of Appeals first considered the language of § 544(a), which grants bona-fide-purchaser status to the trustee as of the commencement of the case. A bankruptcy case commences upon the filing of the bankruptcy petition, and only the petition. The schedules may be filed at the same time or within 15 days of the case being commenced by the filing of the petition. Chase Bank argued that in this case the schedules were filed at the same time as the petition, so the Chapter 7 trustee had knowledge of the lien upon the case being commenced. Therefore, Chase Bank contended that knowledge of the lien from the schedules precluded the Chapter 7 trustee from being a bona fide purchaser, citing the court to *Briggs v. Kent* (*In re Professional Investment Properties of America*), 955 F.2d 623 (9th Cir. 1992).

Professional Investment was an involuntary bankruptcy case brought by the creditor holding the unrecorded deed of trust. The existence of the unrecorded deed of trust was shown on the face of the petition, and the Ninth Circuit ruled in that case that the trustee could not be a bona fide purchaser since the petition itself disclosed the existence of the lien upon the commencement of the case. The court in *Professional Investment* concluded that the trustee's status as a bona fide purchaser was created the instant the petition was filed (commencing the case). The scope of *Professional Investment* was expressly limited to involuntary bankruptcy cases where the unrecorded lien is stated on the petition itself.

For a voluntary bankruptcy case, no disclosure of the liens, recorded or unrecorded, is made by the debtor on the petition. At the instant the case is commenced, no notice exists of the unrecorded lien. This is consistent with the express language of § 544, that the bona fide purchaser status is given "without regard to any knowledge of the trustee." 11 U.S.C. § 544(a). On a practical level, this interpretation is necessary to prevent debtors from using bankruptcy petitions to favor one creditor over others by disclosing a theretofore secret lien in the bankruptcy schedules. To do otherwise would violate a fundamental principle of bankruptcy: to provide a fair, pro rata distribution of assets within the classes of creditors.

State law controls the trustee's status as a bona fide purchaser for value without notice. Constructive notice of a lien arises only from the time that the lien is filed with the county recorder. An unrecorded lien or conveyance is void as to any subsequent purchaser for value in good faith and for value. By operation of 11 U.S.C. § 544, the trustee is deemed to be such a bona fide purchaser for value with a perfected interest in the property the instant the voluntary petition is filed. This voids the unrecorded interest of Chase Bank in this case.

Chase Bank also argued that it was entitled to enforce the doctrine of equitable subordination since Chase's refinance paid off the existing debt, which was recorded by the prior deed of trust. Under the doctrine of equitable subordination, one who pays an obligation for which another is primarily liable is then given by equity the protection of any lien securing the debt paid, and may enforce that lien against the principal debtor or collect the obligation from the principal debtor. The Ninth Circuit rejected this theory on three points. First, no lien existed to be enforced, as it had been reconveyed. Though some liens can be revived, this isn't the case where it works to prejudice senior or equal equities. Second, the right of subrogation cannot be applied to injure the interests of a bona fide purchaser for value, the trustee. The lien having been discharged as a matter of record, it cannot be later resurrected to surprise the bona fide purchaser. Finally, California law gives priority to the bona fide purchaser over one claiming equitable subordination.

People's Capital and Leasing Corp. v. Big3D, Inc. (*In re* Big3D, Inc.), 438 B.R. 214 (B.A.P. 9th Cir. 2010)

Facts

The debtor, Big3D, Inc., operated a commercial printing business and leased its equipment from People's Capital and Leasing Corporation (PCLC) under a 60-month lease, with monthly payments of $8,516 and a $101 purchase option at the end of the term. When Big3D defaulted on its payments, PCLC filed suit in state court and obtained a prejudgment writ of execution for the equipment on October 21, 2008. Big3D filed a Chapter 11 petition on October 23, 2008. On March 20, 2009—almost six months later—PCLC filed a motion for relief from the automatic stay or adequate protection payments. PCLC submitted the declaration of an expert witness who opined that the equipment's value had been stable for the four months leading up to the petition date, then declined at a variable rate based on "deteriorating economic conditions" between the petition date and the date of his report, March 9, 2009, and continued to decline at the rate of 12% per year, or $3,500 per month. At the hearing, the parties and the bankruptcy court agreed that the debtor would pay PCLC $3,500 per month going forward for adequate protection. The court denied PCLC's request for adequate protection payments as compensation for the property's alleged loss in value from the petition date to the date the motion was filed.

PCLC argued on appeal that the bankruptcy court should have ordered adequate protection payments from the petition date based on the holding of the BAP in *Paccom Leasing Corp. v. Deico Electronics, Inc. (In re Deico Electronics, Inc.)*, 139 B.R. 945 (B.A.P. 9th Cir. 1992). Big3D argued that *Deico* did not require payments from the petition date, and then argued, in the alternative, that the BAP should reconsider the *Deico* holding and determine that a creditor should never be awarded adequate protection payments for the period before the creditor files its motion. Because of the challenge to the continuing viability of *Deico*, the BAP heard the appeal en banc.

Issues

1. Should the bankruptcy court have granted adequate protection payments from the filing of the petition date to the filing of the motion?
2. Should the BAP modify the rule announced in *Deico* and limit a creditor to adequate protection payments going forward from the date of the creditor's motion?

Holding

The creditor was not entitled to retroactive adequate protection payments under the existing rule

The BAP affirmed the bankruptcy court's decision under the *Deico* holding and found that the bankruptcy court had not abused its discretion in denying retroactive adequate protection payments. *Deico* held that (1) adequate protection payments are intended to compensate the secured creditor only for the losses occasioned by the debtor's bankruptcy; (2) adequate protection is payable for only that period of time after the creditor would have exercised its state court remedies; and (3) the bankruptcy court has broad discretion in fixing the beginning date, amount, and frequency of adequate protection payments.

Here, PCLC argued that it was entitled to retroactive adequate protection payments because it obtained its state court remedy two days before the bankruptcy petition. The BAP disagreed. The bankruptcy court record showed that PCLC had only obtained a prejudgment writ of execution two days before the filing; it would take weeks, if not months, for the creditor to remove and sell the property, and it was only at that point that the creditor would be protected from declines in value. Further, the testimony of PCLC's expert was not helpful, because the testimony referenced a value as of the petition date, a "variable" rate of depreciation, and then a value as of the date of the expert's report; it did not enable the court to determine when exactly the equipment began depreciating or the rate at which depreciation occurred after the theoretical point in time when PCLC would have exercised its remedies. Therefore, the bankruptcy court did not abuse its discretion in denying retroactive payments. Finally, the BAP agreed that it was a proper exercise of the bankruptcy court's discretion to consider the creditor's six-month delay in filing its motion.

The Deico rule does not require modification

The BAP did not see the need to modify the rule announced in *Deico.* The BAP noted the trend in the case law setting the point for commencement of adequate protection payments at the filing of the motion, but emphasized a structural distinction: "while a request is a prerequisite to determining if adequate protection should be awarded under §§ 362(d)(1) and 363(e), what constitutes adequate protection is defined in § 361," and § 361 contains no temporal limitation precluding an adequate protection award for depreciation occurring between the petition date and the request for adequate protection. Thus, the flexible approach of *Deico* was fundamentally sound, and the bankruptcy court should have the discretion to determine the beginning date, amount, and frequency of adequate protection payments.

Concurring opinions

Interestingly, there were two separate concurring opinions. The first would have "corrected" the *Deico* holding and established a bright line rule that adequate protection is not available to a secured creditor for the decline in value occurring during a bankruptcy case prior to the filing of a request for such relief. The second agreed with the result, but disagreed with the decision to hear the matter en banc.

Fitzgerald v. John Leldon Gray Trust (*In re* Fitzgerald), 428 B.R. 872 (B.A.P. 9th Cir. 2010)

Facts

The debtor was sued in state court by his former corporation for breach of fiduciary duty and related claims. Debtor alleged cross-claims in the lawsuit against the corporation and debtor's partners in the venture. Upon filing his Chapter 7 bankruptcy, debtor listed his interest in the company, valued at $0, but did not list the cross-claims as an asset. Debtor failed to appear for two scheduled § 341 meetings, and never provided testimony about the value of either asset. The Chapter 7 trustee filed a motion to approve the sale to debtor's former business partner of both the interest in the company and the cross-claims. While the trustee provided support for valuing the interest in the company at $0 because of the unlikelihood of any distribution, he did not provide any analysis of the value of the cross-claims beyond the fact that the proposed sale price was sufficient to cover debtor's scheduled unsecured claims and administrative expenses. Debtor failed to object in writing to the sale motion, but appeared at the hearing. The bankruptcy court approved the sale over his objection, after one bid increase. Debtor appealed, but failed to obtain a stay of the order and both sales were closed while the appeal was pending and the cross-claims dismissed.

Issues

1. Is the appeal moot?
2. Did debtor preserve his objection to the Sale Order?
3. Did the bankruptcy court abuse its discretion by issuing the Sale Order?

Holding

The BAP first noted that the appeal was not moot even though the sale had closed, the cross-claims had been dismissed, and no stay had been obtained. The court found (1) there was no statutory mootness because there was no evidence to support a good-faith finding for a sale to be final under § 363(m); and (2) there was no equitable mootness because the company sale could apparently be undone as it was a sale to an insider, not a third party, and the cross-claims appeared to be revivable as the rest of the lawsuit was still pending, and effective relief could still be granted.

The court also found that the debtor had preserved his objection to the sale even though he had failed to file a written opposition. Debtor had appeared and objected at the sale hearing and the bankruptcy court had considered his objections. Despite procedural anomalies, debtor's actions neither consented to the sale nor waived his rights to object to it on appeal.

As to the Sale Order, the BAP noted two things were needed to establish that a sale was in good faith for purposes of § 363(b): (1) an identifiable purchaser (2) who gives full value. While the debtor hadn't presented any evidence as to the "full value" of the cross claims—either in his schedules or by appearing at the § 341 meeting—the trustee bore the burden of showing full value, and the trustee had also failed to present any analysis why the proposed sales price was fair and reasonable. The BAP noted that a price is less likely to be reliable when competition for the asset may be constrained. And the sale of a cause of action to the defendant of that claim, where the only other competitor to purchase the claims may be the debtor–plaintiff, is an example of constrained competition where the sale price warrants more scrutiny. The bankruptcy court had the ultimate responsibility to ensure that optimal value was being realized by the estate. The bankruptcy estate is a trust administered by the trustee. It was not enough for the trustee to stop his inquiry upon determining the sale price was adequate to cover administrative expenses and the claims of non-insider creditors. Because of this failure by the trustee and the bankruptcy court, and the court's failure to consider the sale of the claim as a Rule 9019 compromise and apply a "fair and equitable settlement" analysis under Rule 9019, the BAP reversed the sale order.

Larry Robert Foster v. Double R Ranch Ass'n (*In re* Foster), 435 B.R. 650 (B.A.P. 9th Cir. 2010)

Facts

Chapter 13 debtor Larry Robert Foster filed an adversary proceeding against his homeowners' association (HOA) seeking a declaration that postpetition HOA dues he owed to the HOA were debts dischargeable under 11 U.S.C. § 1328(a).

Issue

Are HOA dues that are assessed and owed after the order for relief nondischargeable as long as the debtor continues to reside on the property?

Holding

After affirming the bankruptcy court's exercise of discretion to grant summary judgment on shortened time, the BAP determined the HOA dues at issue were not dischargeable. The BAP first found that the HOA fees were potentially dischargeable despite 11 U.S.C. § 523(a)(16), which renders HOA fees nondischargeable in certain circumstances, but not where a discharge is sought under 11 U.S.C. § 1328(a). The BAP then analyzed Washington state law and concluded the affirmative covenant to pay HOA dues is not merely contractual in nature. Instead, it creates a property right as a covenant running with the land. Thus, Foster's personal liability for the dues is an incidence of ownership of his property, which is not affected by the filing of his bankruptcy and not subject to discharge. To release the debtor from a recorded covenant is to take a property interest away from the HOA and give it to the debtor. This would be tantamount to a forced conveyance of a property interest, which is not only beyond the scope of a Chapter 7 discharge, but is also in violation of the Fifth Amendment. Therefore, to the extent the debtor maintains legal, equitable, or possessory interest in the property, the postpetition HOA fees are nondischargeable.

Eric Mwangi, et al. v. Wells Fargo Bank N.A. (*In re* Mwangi), 432 B.R. 812 (B.A.P. 9th Cir. 2010)

Facts

The debtors, Eric and Pauline Mwangi, filed a Chapter 7 petition on August 3, 2009. The debtors had four bank accounts at Wells Fargo Bank, N.A., on the date of their petition. Wells Fargo has a policy of placing a "temporary administrative pledge" on accounts of debtors who have filed for Chapter 7 relief and sending a letter to the trustee asking for further instructions. Wells Fargo did not receive any instructions from the trustee, but did receive a demand from the debtors to release the funds because the debtors claimed an exemption in 75% of the funds held in the Wells Fargo accounts. Wells Fargo refused to release the funds to the debtors.

The debtors filed a motion seeking sanctions against Wells Fargo for willful violation of the automatic stay under 11 U.S.C. § 362(k). The bankruptcy court denied the debtors' motion, stating that the exempt property was never part of the bankruptcy estate and therefore not subject to the automatic stay. Further, the bankruptcy court held that Wells Fargo did not violate the automatic stay because it took no action to collect, assess, or recover against the debtors.

Issues

1. Does exempt property ever become a part of the bankruptcy estate?
2. Do the debtors have standing to file and prosecute the automatic stay motion?
3. Is an administrative freeze in violation of the automatic stay?

Holding

Is exempt property part of the bankruptcy estate?

A bankruptcy estate is automatically created upon a Chapter 7 bankruptcy filing. 11 U.S.C. § 541(a). Deposits in a debtor's bank account become property of the estate upon the commencement of the bankruptcy case, and exemptions represent the debtor's attempt to reclaim those assets. Parties in interest can object to an exemption claim within a 30-day period, and when the period ends, the property claimed as exempt leaves the estate and revests in the debtor. The BAP found that until the property claimed as exempt revests, the property is estate property and the debtor holds an inchoate interest in the property. *Id*. Therefore, the bankruptcy court erred in stating that the exempt property never became part of the bankruptcy estate.

Standing

A claim of exemption in a property of the estate bestows standing on debtors for the purposes of a motion alleging willful violation of a stay pursuant to 11 U.S.C. § 362(k)(1).

Does an administrative freeze violate the automatic stay?

An automatic stay arises automatically upon the filing of a bankruptcy petition and prohibits any act that exercises control over the property of the estate. *See* 11 U.S.C. § 362(a)(3). Here, Wells Fargo unquestionably exercised control over the property of the estate. Wells Fargo could have (1) paid the account funds to the trustee; (2) released the funds to the debtors; or (3) sought direction from the bankruptcy court—but it did not do any of these. Instead, it held the funds until it received a demand "that it alone deemed appropriate." The BAP concluded, "If that is not 'exercising control over' the funds, we don't know what is." After concluding that Wells

Fargo violated the stay, the BAP remanded the case for determination of whether the violation was willful and what damages, if any, were appropriate.

Battle Ground Plaza, LLC v. Douglas Ray, et al. (*In re* Ray), 624 F.3d 1124 (9th Cir. 2010)
Appeal from the Ninth Circuit Bankruptcy Appellate Panel

Facts

Douglas M. Ray was a co-owner of commercial real estate consisting of a shopping center known as the Battle Ground Plaza Shopping Mall. Ray filed a Chapter 11 bankruptcy that resulted in a confirmed plan of reorganization. The bankruptcy court approved the sale of a certain parcel of real property adjoining the mall to someone other than Battle Ground Plaza LLC ("BG Plaza," which held a first right of refusal).

The sale of the parcel of real property was approved "free and clear of all liens and encumbrances . . . including but not limited to the right of first refusal granted to [BG Plaza]" over BG Plaza's objection. BG Plaza did not appeal the sale order. Ray's bankruptcy case was closed. Subsequently, BG Plaza brought a breach of contract action against Ray and others in state court seeking specific performance of its first refusal rights. After reopening the case, the bankruptcy court determined that it had jurisdiction over the matter and granted summary judgment in favor of Ray and his co-owner. BG Plaza appealed and the BAP affirmed. BG Plaza appealed to the Ninth Circuit.

Issue

Did the bankruptcy court have jurisdiction over a postconfirmation breach of contract claim?

Holding

Addressing issues of apparent first impression, the Ninth Circuit held that BG Plaza's claim for breach of contract neither "arose in" nor "arose under" the Bankruptcy Code. Moreover, BG Plaza's claim lacked a "close nexus" to the bankruptcy plan or proceeding and, thus, the bankruptcy court did not retain "related to" jurisdiction over it. The court also found that the bankruptcy court lacked ancillary jurisdiction over the matter. The court reversed and remanded with instructions to dismiss the case.

The court reasoned that BG Plaza's claim was a state-law contract action that was independent of the bankruptcy case. The claim did not depend on an administrative matter unique to the bankruptcy process, but could have been brought in another forum. The claim could have existed entirely apart from the bankruptcy proceeding and did not necessarily depend on resolution of a substantial question of bankruptcy law.

The fact that the plan confirmation order stated that the bankruptcy court would "retain jurisdiction of this case to determine any controversies in connection with assets of the bankruptcy estate" was insufficient to bring BG Plaza's postconfirmation, post-closing breach-of-contract action against Ray within the bankruptcy court's ancillary jurisdiction. Hearing a breach-of-contract claim predicated on evidence that came to light after the bankruptcy case was closed, its creditors were paid, and the debtor received his discharge stretched "the limits of the bankruptcy court's ancillary jurisdiction too far, going beyond what is necessary for the bankruptcy court to effectuate its decrees."

According to the court, once the bankruptcy court confirms a plan of reorganization, the debtor is free to go about its business without further supervision or approval of the court and, concomitantly, without further protection of the court. It found that the state court was perfectly capable of assessing whether BG Plaza's claim was viable given that the sale of the property had already been finalized and approved in the bankruptcy case.

Brendon Keith Retz v. Richard J. Samson, Chapter 7 Trustee, et al. (*In re* Brendon Keith Retz), 606 F.3d 1189 (9th Cir. 2010)

Appeal from the Ninth Circuit Bankruptcy Appellate Panel

Facts

Brendon Retz's Chapter 7 trustee and Donald Abbey (Retz's former business partner), along with several banks, brought an adversary action to prevent Retz from receiving a discharge. The bankruptcy court ruled in favor of the plaintiffs under 11 U.S.C. § 727(a)(2)(A), (a)(2)(B), (a)(4)(A), and (a)(5). Retz appealed to the BAP. The BAP affirmed the bankruptcy court's ruling, finding that Retz's discharge could have been denied under any of these subsections of § 727. The Ninth Circuit affirmed the BAP's ruling.

Background

Retz formed Timberland Construction, Inc. (TCI) after graduating from college with a degree in business management. He was the sole shareholder of TCI, which was in the real estate and construction business in the Whitefish, Montana, area.

Abbey was a successful and experienced California real estate investor. Abbey wanted to build a multi-million dollar residence in Montana. Abbey decided to form a new construction and development company with Retz, which resulted in the creation of Timberland Construction, LLC (TCLLC). Abbey and TCI were the governing members of TCLLC. Abbey was to contribute $300,000, and TCI would contribute its assets and liabilities.

Two years later, Abbey ran into Retz on the "comp" floor of the Bellagio Resort & Casino in Las Vegas. Abbey was surprised that someone earning $40,000 a year was getting comped at the Bellagio. He became suspicious and went to Montana. Abbey discovered that TCLLC had entered into partnerships and loan agreements in violation of TCLLC's operating agreement, which required Abbey's written permission. Thereafter, Abbey brought in an accountant to audit the books of TCLLC, and the accountant found numerous accounting irregularities, including suspicious transfers between Retz and TCLLC. As a result of these discoveries, Abbey began withdrawing financial support from TCLLC.

There was a state court proceeding, after which Retz filed his bankruptcy. Retz admitted that his Schedules and Statement of Financial Affairs (SOFA) were incomplete (among other things, he omitted valuable watches, a bank account, a Cadillac, an Audi, the sale of a helicopter and hangar, two years of income, prepetition transfers to his father, and the fact that he had prepaid his home mortgage). After he filed bankruptcy, Retz and his wife, Misty, continued to use credit cards and other funds for their personal and business use.

Ninth Circuit Opinion

The Ninth Circuit upheld the ruling that Retz's errors and omissions in his Schedules and SOFA were false oaths related to material facts sufficient to support the bankruptcy court's finding that Retz's discharge should be denied pursuant to § 727(a)(4)(A). The court noted that it did not find credible Retz's argument that, having "dumped 28,000 pages of largely unorganized documents on the trustee after repeated requests to explain his convoluted financial affairs," the trustee could have figured out what had happened on his own. The court also did not believe Retz's "advice of counsel" argument given "the significant number of omissions and errors, the large monetary value of the omitted transfers, and the fact that Retz signed the Schedules and SOFA without reading them."

As to the § 727(a)(2) ruling, the bankruptcy court had found that Retz's sale of a house to his brother for $60,000 under market within one year prior to bankruptcy constituted an intent to hinder, delay, or defraud creditors sufficient to deny discharge. Retz argued that he had not intended to defraud creditors, that he had arranged the sale more than a year prior to his bankruptcy, and that he had various oral agreements with Abbey that overrode their written agreement. The bankruptcy court did not find Retz's testimony credible, including Retz's testimony regarding Abbey's nonchalance about his business affairs, which was "wholly inconsistent with the evidence of Abbey's business practices in dozens of companies." The bankruptcy court found four badges of fraud present in the transaction with Retz's brother. The court rejected another "advice of counsel" argument from Retz. The BAP and the

Ninth Circuit affirmed the § 727(a)(2) ruling. Retz's education and experience as a business owner made him hard to believe.

Moving on to a § 727(a)(2)(B) finding, the Ninth Circuit also affirmed denial of discharge because of Retz's participation in the postpetition transfer of a family business (of which he was part owner) to an LLC owned by his mother. This transfer resulted in the only asset of the family business being a promissory note in the amount of $850,000 payable in 30 years at 6% interest. The trustee was not consulted about this transfer and Retz was evasive with the trustee when asked for information about the family business. On appeal, Retz tried to disclaim responsibility, but to no avail. As a debtor in bankruptcy, he had a duty to share full information with the trustee, and his failure to do so was deemed circumstantial evidence of his intent to hinder, delay, or defraud creditors.

The final ground upon which the bankruptcy court denied discharge was § 727(a)(5), the failure of the debtor to explain loss of assets. In addition to the problems with the SOFA, there was evidence in the record that Retz went on a spending spree just before he filed bankruptcy, purchasing computers, office furniture, servers, luxury cars, and a helicopter and hangar. He also went on several gambling trips where he lost thousands of dollars. Again, Retz sought to blame the trustee, contending that the trustee had the relevant documents and should have been the one to determine what had transpired. The Ninth Circuit was not persuaded. They found that the record amply supported this part of the judgment against Retz. The trustee and the creditors are not required to "search through a paperwork jungle in the hope of finding an overlooked needle in a documentary haystack." Retz did not explain his lack of assets to meet his liabilities, and no one else could either.

Smith v. Rojas (*In re* Smith), 435 B.R. 637 (B.A.P. 9th Cir. 2010)

Facts

Two sets of debtors stripped off second mortgages on their homes, which the court determined to be wholly unsecured liens. After the strip offs, the Chapter 13 trustee moved to dismiss the cases as exceeding the § 109(e) unsecured debt limits. The bankruptcy court included the amount of the stripped off liens as unsecured debts in calculating the debtors' debt limits and dismissed both cases.

Issues

The court was to determine whether a debt secured by a consensual lien that is wholly unsecured under § 506(a) should be counted as unsecured debt for purposes of determining the eligibility of debtors for Chapter 13 relief under § 109(e).

Holding

The BAP found that *In re Scovis,* 249 F.3d 975 (9th Cir. 2001), was binding precedent, and that under 11 U.S.C. § 506(a) the claims of second lienholders were to be counted as unsecured claims as of the petition date for § 109(e) eligibility, even though the strip off took place after the petition date. The court rejected debtors' argument that eligibility should be determined by looking at the characterization of the debt on the originally filed schedules. Debts listed as secured on Schedule D should be included in the calculation of unsecured debt limits for § 109(e) purposes when the debt's real status could be "readily ascertainable" from the schedules. In both of the cases on appeal, the bankruptcy court had a sufficient degree of certainty from the schedules—comparing the values of the homes and the secured debt amounts—that the second liens were, in fact, wholly unsecured and should therefore be included in the unsecured debt calculation.

The BAP also rejected the debtors' arguments that the second liens should be treated as secured because the lienholders retained all of their rights and remedies under state law, as well as their security interest, as the liens would not become void until the Chapter 13 discharge is entered or eliminated in foreclosure. The court recognized that while property right determinations in the bankruptcy court are usually controlled by state law, that did not mean that merely holding a security interest on the petition date means a creditor is secured for purposes of the Bankruptcy Code, generally, or for § 109(e), specifically.

Richard S. Berry v. United States Trustee, et al. (*In re* Leonard Sustaita, Jr.), 438 B.R. 198 (2010)

Appeal from the United States Bankruptcy Court for the District of Arizona

Facts

Richard S. Berry, a disbarred attorney, appealed an order of the bankruptcy court that, among other things, enjoined him from acting as a bankruptcy petition preparer (BPP) and imposed a civil penalty of $100,000 against him. Berry argued that he was denied due process. The BAP affirmed all but the civil penalty portion of the bankruptcy court's judgment.

Background

After he lost his license to practice law, Berry continued providing legal services, including bankruptcy legal services. He was imprisoned for six months, but he continued doing business under the name Why Pay A Lawyer (WPAL).

Berry's involvement with WPAL did not go unnoticed. An application for an order to show cause (OSC) was filed by one of the Chapter 13 trustees. The bankruptcy court issued OSCs for numerous violations of the bankruptcy code and previous injunctions issued against Berry by the bankruptcy court.

The various pleadings and notices regarding the OSCs went to WPAL's address and/or to Berry's home address. Berry did not appear at the initial hearing on the OSCs or for a deposition. Berry did not file any documents until two days prior to an evidentiary hearing, when he filed a request for a 60-to-90-day continuance. At the same time, Berry requested that the bankruptcy judge recuse himself.

Berry did not appear at the evidentiary hearing. The bankruptcy court denied Berry's request for a continuance, denied his request for recusal, and subsequently entered judgment against Berry. The bankruptcy court found that Berry was a BPP and a debt relief agency and then imposed statutory fines for numerous violations of § 110, ordered the disgorgement of fees, imposed a civil penalty under § 526 of $100,000, permanently enjoined Berry from acting or advertising as a BPP, and referred the matter to the U.S. Attorney for the filing of criminal contempt proceedings against Berry. Proposed orders were mailed to Berry at his home address, the WPAL address, and to a P.O. box he had directed for service. Berry did not file an objection to the lodged orders.

Subsequently, Berry moved for a new trial or relief from the judgment. He asserted that he was denied due process and that the bankruptcy judge was biased against him. He alleged that he was never served with the OSCs and that he only learned of the proceedings subsequent to the initial hearing during a telephone conversation with a staff attorney from the U.S. Trustee's Office. Berry claimed to have informed the staff attorney that he wished to receive mail via the P.O. box. Berry also reminded the bankruptcy judge that he had requested a continuance and that he had requested that the court recuse itself. He also asserted substantive defenses to the allegations against him (one of them being that he was merely selling "bankruptcy kits").

The bankruptcy court found that Berry had received multiple notices of the proceedings but that he had chosen not to appear or defend. Berry filed a notice of appeal to the BAP.

BAP Decision

On appeal, Berry made various due process arguments regarding service. The BAP did not find these arguments persuasive. It found that Berry had received multiple notices regarding the pendency of the proceeding. Moreover, Berry admitted to having actual notice. The BAP found that Berry was not diligent in his efforts to avoid the purported need for a continuance since he was served with multiple notices and documents over several months, but only requested the continuance two days prior to the evidentiary hearing.

Moreover, the BAP found that, although the § 110(j) injunction action should have been brought by way of an adversary proceeding, the failure to do so was a harmless error. Not only had Berry failed to make the argument (and therefore arguably waived it), but Berry had received all the process he would have received in an adversary proceeding.

As to Berry's argument that the bankruptcy judge was biased against him, the BAP did not see anything in the record that created a reasonable doubt concerning the bankruptcy judge's impartiality. Furthermore, a criminal contempt referral to the U.S. Attorney by the bankruptcy judge did not elevate the enforcement proceedings against him to the level of a criminal proceeding, despite Berry's arguments to the contrary.

Pivotal Issue on Appeal

What concerned the BAP was the bankruptcy court's decision to impose a $100,000 civil penalty against Berry under § 526(c)(5)(B). This section authorizes the court to impose an appropriate civil penalty on the court's own motion or on the motion of the U.S. trustee. And, while the Chapter 13 trustee's Application for Sanctions urged the bankruptcy court to grant punitive sanctions under § 526(c)(5)(B), this was found to be insufficient to alert Berry that the court was acting on its own motion or considering a civil penalty under this section. In addition, the BAP did not see any indication that the U.S. trustee had moved for sanctions under this section. The BAP found that Berry was not given the particularized notice necessary prior to the imposition of sanctions (including a description of the alleged misconduct as well as the source of the court's sanctioning power).

The BAP reversed the bankruptcy court's decision to impose a civil penalty against Berry, but otherwise affirmed the bankruptcy court's decision.

Alex Zotow, et al. v. Jan P. Johnson, et al. (*In re* Zotow), 432 B.R. 252 (B.A.P. 9th Cir. 2010)

Facts

Debtors Alex and Theresa Zotow filed a Chapter 13 petition. BAC Home Loans Servicing, LP sent a notice to the Zotows, increasing their postpetition mortgage payments because of its improper inclusion of prepetition escrow arrears in its payment calculation. The Zotows made postpetition plan payments to the Chapter 13 trustee in the amount due before this increase, but the trustee objected to the feasibility of the Zotows' plan because it proposed the lower payment amount. The plan payments made by the Zotows to the trustee, including the monthly mortgage amount, had been forwarded in the ordinary course to BAC, which improperly applied them to the prepetition escrow arrears. The Zotows objected to the BAC proof of claim for not including the full amount of the escrow arrears, which was sustained by the bankruptcy court and not challenged on appeal. The debtors also sought damages for the violation of the automatic stay as part of their claim objection, which were denied.

Issues

Did BAC's act of sending notice and improperly increasing the Zotows' monthly payments to include prepetition escrow debt, as well as improperly applying postpetition payments to prepetition debt, violate § 362?

Holding

The automatic stay prevents communications that are harassing or coercive in nature to put pressure on the debtor to make payments. However, the automatic stay does not prevent informative, statement-type documents that provide notice of the amount currently due. The BAP determined the notice sent by BAC was not in violation of the automatic stay, even though the notice was triggered by the filing of bankruptcy. The notice was informational in nature and did not indicate that BAC took steps to collect their prepetition debt, and the Zotows needed the information to determine the feasibility of their plan. Further, the BAP did not penalize BAC for the improper inclusion of prepetition escrow debt in BAC's notice, because the Zotows should have challenged the increased payment amount promptly by motion to the court.

Although BAC misapplied the payments received, they were received as part of the Chapter 13 process, pursuant to a local bankruptcy rule, and BAC did not engage in any act to possess or collect the payments. BAC's misapplication of postpetition payments thus did not violate the automatic stay of 11 U.S.C. § 362(a)(6).

Hamilton v. Lanning (*In re* Lanning), 130 S. Ct. 2464 (2010)

Facts

Approximately six months before the debtor, Stephanie Kay Lanning, filed her Chapter 13 petition, she received a one-time buyout from her former employer. Based on the income from her new job, the debtor calculated disposable income of $149.03. Her Chapter 13 plan provided that she would pay $144 per month for 36 months to her unsecured creditors.

The Chapter 13 trustee objected to the plan. If the trustee objects, a debtor's plan must either pay all creditors in full or devote all of her "projected disposable income" to plan payments. The trustee applied a "mechanical approach" to calculate the debtor's projected disposable income, using her prior six-month average monthly income—which was significantly higher than her current income because of the one-time buyout. Using the mechanical approach, the trustee determined that the debtor's monthly payment under the plan needed to be $756.

The bankruptcy court agreed with the debtor and held that the word "projected" in 11 U.S.C. § 1325(b)(1)(B) required courts to consider actual income as reported on Schedule I. The Chapter 13 trustee appealed to the Tenth Circuit's Bankruptcy Appellate Panel, which affirmed the bankruptcy court. The Tenth Circuit BAP noted that although Congress redefined "disposable income" in 2005, it did not alter the preexisting term "projected disposable income." Thus, the BAP concluded that the preexisting practice of determining projected disposable income by referencing Schedules I and J and other relevant evidence of income did not need to be altered. The trustee appealed the BAP's decision and the Tenth Circuit affirmed. The Tenth Circuit held that when calculating projected disposable income, one should begin with the presumption that the figure yielded by the mechanical approach is correct. The presumption may be rebutted by evidence of substantial change in the debtor's circumstances. The trustee appealed the Tenth Circuit decision.

Issue

How should the debtor's projected disposable income be calculated?

Holding

In a Chapter 13 bankruptcy, if the trustee or a creditor objects to a plan, the plan must either pay creditors in full or commit all of the debtor's "projected disposable income" to the repayment of creditors. 11 U.S.C. § 1325(b)(1)(B). While § 1325(b)(2) defines "disposable income" as current monthly income less "reasonably necessary" expenses, the term "projected disposable income" is not defined in the Bankruptcy Code. Lower courts have historically used two approaches to determine "projected disposable income": the mechanical approach and the forward-looking approach. The mechanical approach calculates projected disposable income by multiplying the past average monthly disposable income for the six months leading up to the petition date by the number of months in a debtor's plan. *Id*. The forward-looking approach begins with the mechanical approach but allows for adjustments if there are significant changes known or virtually certain in the debtor's financial circumstances.

In an 8–1 decision, with Justice Scalia dissenting, the Supreme Court adopted the forward-looking approach as the preferable method, listing several factors in support of its decision: (1) the ordinary meaning of the word "projected" allows for adjustments based on future events; (2) if Congress had wanted simple multiplication, it would have used the word "multiplied" as it did in other Code sections; (3) pre-Bankruptcy Abuse Prevention and Consumer Protection Act case law favors the forward-looking approach for determining "projected disposable income" and Congress did not amend the term "projected disposable income" in 2005; and (4) the mechanical approach clashes repeatedly with the terms of 11 U.S.C.

§ 1325(b), which references income "to be received" during the plan commitment period.

Based on these reasons, the Supreme Court affirmed the Tenth Circuit decision and held that when calculating a debtor's projected disposable income, "the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation."

Elaine T. Marshall *ex rel.* Estate of E. Pierce Marshall v. Howard K. Stern *ex rel.* Estate of Vickie Lynn Marshall (*In re* Marshall), 600 F.3d 1037 (9th Cir. 2010)

Facts

The debtor, Vickie Lynn Marshall, popularly known as Anna Nicole Smith ("Smith"), alleged her late husband's son E. Pierce Marshall ("Marshall") tortiously interfered with her interest in her late husband's probate estate. The claim was brought as a compulsory counterclaim to Marshall's nondischargeable defamation claim brought against Smith in bankruptcy court. The bankruptcy court deemed the matter a "core" matter and entered judgment in Smith's favor. On appeal, the district court deemed the matter "non-core," heard additional evidence, and also entered judgment in Smith's favor.

However, this tortious interference claim was, for a time, being litigated simultaneously in the probate court in Texas, until this claim was non-suited in the probate court. Despite her victories in the bankruptcy and district courts, Smith lost a jury trial on the same claim in the probate case. The probate court jury verdict was entered after the bankruptcy court judgment, but before the district court judgment.

On this case's first visit to the Supreme Court, the Ninth Circuit was reversed for construing too broadly the "probate exception" to the bankruptcy court's subject-matter jurisdiction. *Marshall v. Marshall,* 547 U.S. 293, 297 (2006). The case was remanded to the Ninth Circuit, which reversed the district court's judgment in favor of Smith. Certiorari has again been granted and this dueling court matter is once more before the Supreme Court.

Issues

Is a compulsory counterclaim, based on a state-law cause of action, a core proceeding under 11 U.S.C. § 157(b)(1)? If the counterclaim is not a core proceeding, should the Texas probate judgment against the debtor, which had been decided before the district court decision but after the bankruptcy court decision, be given preclusive effect?

Holding

The Ninth Circuit held that a counterclaim can be compulsory as defined in Fed. R. Civ. P. 13(a)(1) for pleading purposes, but not "core" for jurisdictional purposes. It reasoned the test for compulsory counterclaims is broad because it is designed to promote judicial efficiency. In contrast, the standard for determining core proceedings is much narrower because it must comply with the constitutional limitations on the bankruptcy court's jurisdiction, as set forth in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 87 (1982). The Ninth Circuit held that "a counterclaim under § 157(b)(2)(C) is properly a 'core' proceeding 'arising in a case under' the Code only if the counterclaim is so closely related to the proof of claim that the resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself." If the counterclaim, whether compulsory or not, is merely "related to" the bankruptcy case, it fails the constitutional definition of a core proceeding. While claim proceedings can arise in or under bankruptcy cases, and be within the bankruptcy court's core jurisdiction, Smith's compulsory counterclaim was far broader in temporal scope and size, and it covered additional legal elements not essential to the resolution of Marshall's limited defamation claim. Smith's counterclaim was thus separate from the bankruptcy process, and the bankruptcy court lacked core jurisdiction to resolve it.

Finding that the counterclaim was not a core proceeding was determinative of the preclusion issue. Because the counterclaim was not a "core proceeding," the bankruptcy court's tortious interference judgment, albeit prior in time to the probate judgment, was not within the scope of its constitutional authority. The Texas probate court's decision was thus the first final judgment since it in turn predated the later, constitutionally sound, district court decision. The district court thus erred in not giving the Texas judgment preclusive effect and denying Smith's tortious interference claim.