Hot Topics and Ethics

Kimberley H. Tyson, Moderator
Ireland Stapleton Pryor & Pascoe, PC; Denver

Mona L. Burton
Holland & Hart LLP; Salt Lake City

Patricia A. Redmond
Stearns, Weaver, Miller, Weissler, Alhadeff & Sitterson, P.A.; Miami

Paul G. Swanson
Steinhilber, Swanson, Mares, Marone & McDermott
Oshkosh, Wis.

Hon. William T. Thurman
U.S. Bankruptcy Court (D. Utah); Salt Lake City

HOT TOPICS AND ETHICS

Moderator
Kimberley H. Tyson, Ireland Stapleton Pryor & Pascoe, PC

Panelists
Hon. William T. Thurman, United States Bankruptcy Court, District of Utah
Mona L. Burton, Holland & Hart, LLP
Patricia A. Redmond, Stearns, Weaver, Miller, Weissler, Alhadeff & Sitterson, PA
Paul G. Swanson, Steinhilber, Swanson, Mares, Marone & McDermott

Supreme Court.

***Law v. Siegel*, 134 S.Ct. 1188 (2014).** Held, in exercising its statutory and inherent powers to sanction abusive litigation practices under 11 U.S.C. § 105(a), a bankruptcy court may not contravene specific statutory provisions. Here, the Trustee sought to surcharge the debtor's $75,000 homestead exemption as a sanction for the debtor's abusive litigation tactics. The trustee had challenged a purported consensual lien on the debtor's home in favor of a "Lili Lin." There were two Lili Lins: (1) one living in California who knew the debtor, but claimed no lien against the property but did describe the debtor's efforts to encourage her to engage in a sham transaction relating to the lien, and (2) one purported living in China who engaged in extensive litigation over the validity of the lien. The bankruptcy court found the debtor had submitted false evidence, the loan was a sham, and the debtor himself had authored and signed many of the documents relating to the loan.

The trustee incurred more than $500,000 in attorneys' fees in litigating the validity of the Lin loan, and the bankruptcy court entered an order surcharging the debtor's homestead exemption. The Ninth Circuit BAP, and the Ninth Circuit, affirmed, both holding a bankruptcy court in exceptional circumstances involving fraud or misconduct by the debtor has the power under § 105(a) to surcharge a debtor's exemption.

The Supreme Court reversed, holding "it is hornbook law" 11 U.S.C. § 105(a) does not empower a bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code: "Section 105(a) confers authority to 'carry out' the provisions of the Code, but it is quite impossible to do that by taking action that the Code prohibits." 134 S.Ct. at 1194. In this case, 11 U.S.C. § 522 provides a homestead exemption is not liable for payment of any administrative expense. The Supreme Court held the bankruptcy court could not override this express provision through use of the powers granted by § 105(a).

***Clark v. Rameker*, 134 S.Ct. 2242 (2014).** The debtor wife in a joint Chapter 7 case inherited a $300,000 IRA from her mother and claimed the funds exempt under 11 U.S.C. §§ 522(b)(3)(C) and (d)(12). The funds retained tax-exempt status but, as they were her mother's IRA proceeds, they were subject to required distributions one year after the receipt and could not be rolled into a traditional IRA or other retirement vehicle tax-free. The trustee

objected to the exemption and the bankruptcy judge denied the exemption finding the funds in the inherited IRA did not constitute "retirement funds" in the hands of the debtor.

The district court reversed the finding, stated it was a close call and, thus, should be decided in the debtor's favor. The trustee appealed. The Seventh Circuit (Easterbrook) found the exemption applied to the nature of the funds in the hands of the debtor and not whether or not the funds were retirement funds at any prior time. Seventh Circuit reversed the district court and declared funds in the hands of the debtor must be both tax-exempt *and* retirement funds; that the retention of tax benefits was not enough to make them qualify. The debtor appealed.

The Supreme Court, in a unanimous decision (Sotomayor) looked to the Bankruptcy Code and found no definition of "retirement funds". Moving on to the plain meaning of the terms, as the Court saw them, would be money set aside for an individual's retirement. Inherited IRAs have attributes which differ from either Roth or traditional IRAs inasmuch as (1) no additional funds can be invested in them; (2) a beneficiary of an inherited IRA is required to withdraw funds in a set period not related to their retirement; and (3) the recipient may draw the entire balance at any time without penalty. The Court focused on Bankruptcy Code's exemption provisions as providing for the protection of the debtor's essential needs to enable a fresh start. Retirement funds set aside by a debtor qualify for that purpose. By contrast, funds in an inherited IRA can be used for any purpose whatsoever by the recipient. The Court agreed with the Seventh Circuit that funds, in order to be exempted as "retirement funds", have to be both exempt from taxation and must be actually intended for retirement. To allow anything that was once an exempt IRA to be withdrawn and reinvested for any purpose would read the "retirement funds" portion of Section 522(b)(3)(C) out of the statute. The Court also observed Section 522(b)(3)(C) did not include the language "the debtor's interest in" as other sections of Section 522 do. The limitation on those sections was not to distinguish between the debtor's assets and the assets of another person, but to set a limit on the value of a particular asset the debtor may exempt.

In response to the debtor's argument that the only reason to construe the statute as the trustee requested is to render inherited IRAs non-exempt, the Court stated a statutory reading that would make one portion superfluous (retirement funds) is less faithful to what Congress intended than a reading that makes the whole statute meaningful but limited. Finally, in response to the debtor's argument that inherited IRAs could still be held for the debtor's retirement, the Court indicated the mere possibility funds could be held for retirement was not enough. An ordinary checking account or an envelope of $20 bills would amount to "retirement funds" if they were in fact held for retirement. That would be too big a door to open.

***U.S. v. Quality Stores, Inc. (In Re: Quality Stores, Inc.)*, 134 S.Ct. 1395 (2014).** Quality Stores, Inc. was a large agricultural retailer which closed on all of its operations, terminated the employment of its employees and made severance payments to those involuntarily terminated employees. The payments were made pursuant to a pre-petition severance plan and a post-petition severance plan designed to encourage employees to defer job searches to aid in the liquidation of the company.

The government took the position the payments constituted wages for FICA purposes and, thus, substantial taxes were due. The debtor had collected and paid in the tax but took the position the payments constituted supplemental unemployment compensation benefits (SUB's) and were not taxable under FICA, thus entitling it to a refund in the amount of the taxes paid in. The debtor filed an action in bankruptcy court seeking to recover the taxes. The bankruptcy court held the debtor was not liable for the taxes and was entitled to a refund of over $1 million. The government filed a motion for reconsideration which the bankruptcy court granted but, upon reconsideration, it ratified its prior decision. The Sixth Circuit affirmed the bankruptcy court and the government appealed to the Supreme Court.

The Supreme Court, in a unanimous opinion (Kagan took no part) (by Kennedy) initially noted the statute, FICA, defines wages broadly as all remuneration for employment including cash value of benefits paid in any medium including cash. "Employment" encompasses any service performed by an employee for the person employing. Under this definition, the Court found severance payments made to terminated employees are remuneration for employment. Section 3121(a)(13)(A) of FICA exempts from taxable wages any severance payments made because of retirement or disability and other sections have specific exemptions from the definition of wages that are not related to termination. The specificity of the definition is evidence Congress intended the definition of wages to be broad.

The Court then addressed whether language of IRC Section 3402(o), which indicates SUB's are to be treated as if they were payment of wages, indicates such benefits are something other than wages. Like FICA, the IRC has specific exemptions from the definition of wages, and severance payments are not exempted.

The Court examined the history of state unemployment benefits which frequently required the recipient to not be paid other "wages" which prompted the IRS to issue a series of revenue rulings in the 50s and 60s taking the position SUB payments were not "wages" under FICA and for the purposes of income tax withholding. However, under the IRC, SUB payments were income to the employees who face significant tax liabilities at the end of the year. Congress' response was to enact IRC Section 3402(o) which treated all severance payments "as if" they were wages for withholding purposes. The Court determined the statute permitted the IRS to treat certain SUB's linked to state unemployment benefits exempt from the definition of wages for the limited purpose of facilitating the receipt of state benefits, and solved the problem of year-end tax liabilities imposed upon an employee by treating all SUB payments "as if" they were wages for withholding purposes. Where SUB payments are not linked to state unemployment benefits, in light of legislative history, the Court found the Congress did not intend severance payments to be excluded from the definition of taxable "wages" under FICA, and, therefore, reversed.

Jurisdiction.

***In re Dietz*, 760 F.3d 1038 (9th Cir. 2014).** Held, a bankruptcy court has jurisdiction to enter a final judgment on non-dischargeability matters because they are necessarily resolved during the process of allowing or disallowing claims against the estate and because they

constitute a public rights dispute. Creditors obtained a non-dischargeable judgment against the debtor based on fraud. The debtor on appeal contended, while the bankruptcy court had subject matter jurisdiction over the adversary proceeding, its entry of a final judgment was unconstitutional, citing *Stern v. Marshall*.

The Ninth Circuit disagreed. Following Chief Justice Roberts' admonition that *Stern* should be applied narrowly, the Ninth Circuit concluded bankruptcy courts may enter final judgments in non-dischargeability actions. Determining the scope of a debtor's discharge is a fundamental part of the bankruptcy process. In addition to concluding a bankruptcy court may determine whether a debt is nondischargeble, the Court held a bankruptcy court may also enter final judgment determining the amount of the debt in question.

Automatic Stay.

***In the Matter of Eric Mwangi*, 764 F.3d 1168 (9th Cir. 2014).** Held, a bank that places an administrative hold on a debtor's bank account pending instructions from the bankruptcy trustee on the disposition of those funds does not violate the automatic stay, even if the funds are exempt.

The debtors filed bankruptcy, asserting an exemption in funds held in their personal bank accounts. The bank placed an administrative hold on the accounts, requesting the trustee to advise the bank on whether to transfer the funds to the trustee or to the debtors. The debtors filed a motion for sanctions seeking damages under 11 U.S.C. § 362(k) against the bank.

The Ninth Circuit affirmed the lower courts' rulings that the bank did not violate the stay, and the debtors could not assert any damages in any event. While an exemption in an asset revests title in the asset in the debtor, because the trustee and creditors may object to a claimed exemption, that revesting does not occur until the deadline for objecting to the exemption passes without objection, or the resolution of a pending objection. Until that occurs, the property in question remains property of the estate, and the debtors lack standing to assert a stay violation.

Because a debtor has no right to possess or control the funds during this period, he does not sustain an injury from the bank's hold on the accounts. Further, once the deadline for objections to exemptions passes and title to the property revests in the debtor, the asset is no longer property of the estate subject to § 362(a)(3). Any action by the bank after that date preventing the debtors from accessing their funds may be actionable under state law, but not under the Bankruptcy Code.

***In the Matter of Rupanjali Snowden*, 769 F.3d 651 (9th Cir. 2014).** Held, a stay violation ends when it ends, and not a minute sooner; or how a small stay violation becomes a really big stay violation. Here, the creditor post-petition effected an electronic funds transfer from the debtor's bank account to it in payment of a $575.00 pre-petition payday loan, resulting in an overdraft of the debtor's account, causing the debtor significant emotional distress. The amount taken from the account in violation of the stay was $816.88.

The debtor filed a motion for sanctions under 11 U.S.C. § 362(k). The debtor offered to settle for $25,000. The creditor rejected the settlement offer and made a counteroffer of $1,445, *but never refunded the monies taken post-petition from the debtor's bank account*. The bankruptcy court entered an order finding a stay violation and awarding the debtor damages, but limited the debtor's attorneys fees to those incurred prior to the date of the creditor's counteroffer.

The Ninth Circuit *reversed* the award of attorneys' fees. It held a debtor is entitled to recover attorneys to the date the stay violation ends. Here, the bankruptcy court erred in finding the creditor's stay violation ended when it made its counteroffer to the debtor's settlement offer. The reasoning for this conclusion is that the creditor never actually returned the money it had wrongfully taken from the debtor's account. Because the creditor was willing to end the stay violation only if the debtor agreed to its settlement terms, Ninth Circuit concluded the debtor was not using the automatic stay as a sword but instead rightfully using it as a shield. "Permitting the violator to short-circuit the remedies available under § 362(k)(1) by making a conditional offer to return the property wrongfully seized in violation of the automatic stay would undermine the remedial scheme of § 362(k)."

§ 363 Sales.

***Rushton v. ANR Company. Inc. (In re CW Mining Company)*, 740 F.3d 548 (10th Cir. 2014).** Following the filing against it of an involuntary bankruptcy petition, CW Mining attempted to transfer all of its operations to an affiliate named Hiawatha. Two other affiliates, ANR Company and COP Coal Development, entered into agreements with Hiawatha to mine coal. Hiawatha used CW Mining's existing equipment and operations, and at times operated under CW Mining's name.

When the bankruptcy court ordered the assets returned to CW Mining, Hiawatha, ANR and COP appealed that order but did not seek a stay pending appeal. While their appeal was pending, the trustee sold the assets to a third party pursuant to an order of the bankruptcy court approving the sale and granting good faith purchaser status to the buyer under 11 U.S.C. § 363(m). Hiawatha, ANR and COP did not appeal the sale order. After the sale closed and the purchaser took possession, the trustee sought to dismiss as moot the appeal of the order requiring the return of the assets to the estate. The district court agreed the appeal was moot and dismissed it. The affiliates appealed that ruling to the Tenth Circuit.

The Tenth Circuit affirmed the dismissal of the appeal as moot. The Tenth Circuit held § 363(m)'s effect is not limited strictly to appeals from the sale order itself, and can apply to appeals from other orders if the outcome of that appeal could effectively modify the sale order. The Court held § 363(m)'s purpose is to protect the public's interest in finalizing bankruptcy sales, and such protection is vital to encourage buyers to purchase estate assets. As a result, § 363(m) will moot appeals in instances where the only remedies available in the appeal will affect the validity of the sale. Since a reversal on appeal of the order compelling return of the assets to the bankruptcy estate would of necessity modify the sale order, § 363(m) required a dismissal of the appeal.

Administrative Claims.

***In re World Imports, Ltd.*, 511 B.R. 738 (Bankr. E.D. Pa. 2014).** This is an outlier case which goes against established case authority, but is being watched. The facts involved a sale of goods by a Chinese company to an American company which later filed bankruptcy. The goods were sold on an FOB bases and were physically received by the debtor within 20 days before it filed bankruptcy. The question before the bankruptcy court was whether, for purposes of an administrative expense under 11 U.S.C. § 503(b)(9), the goods were received by the debtor within 20 days prior to its bankruptcy filing. The parties agreed the goods were physically received by the debtor within the 20-day period, but the debtor and the unsecured creditors committee argued the goods were constructively received by the debtor when they were loaded FOB in China. The bankruptcy court rejected numerous opinions which hold that "receipt" is used in the sense it is under the Uniform Commercial Code — physical receipt. The bankruptcy court instead decided the Uniform Commercial Code should not apply at all, concluding instead a treaty known as the Convention on Contracts for the International Sale of Goods ("CISG") applied to determine the time of the debtor's receipt, since both the United States and China are parties to the treaty. Although the CISG does not define the term "receipt," the bankruptcy court noted the treaty provides parties, unless they otherwise agree, will be deemed to have made their contract in accordance with known usages, known as "Incoterms." The term "FOB" is an Incoterm under which the risk of loss passes to the buyer when the goods are delivered to the carrier. The bankruptcy court concluded delivery to a carrier under FOB terms equates to constructive receipt by the buyer. The result in this case was the goods were determined to have been "received" for purposes of § 503(b)(9) more than 20 days before the case was filed. The *World Imports* decision is currently on appeal.

Proofs of Claim and FDCPA.

***Crawford v. LVNV Funding, LLC,* 758 F.3d 1254 (11th Cir. 2014).** *Crawford* involved two separate cases where Chapter 13 debtors initiated adversary proceedings accusing creditors of violating the Fair Debt Collection Practices Act ("FDCPA"). In both cases, the bankruptcy judge dismissed the adversary proceeding. The cases were consolidated for appeal and the district court affirmed. On further appeal, the Eleventh Circuit held (1) by filing time-barred proof of claims, creditors engaged in conduct that was "deceptive," "misleading," "unconscionable," or "unfair" under the FDCPA; and (2) that filing a proof of claim to collect a debt in bankruptcy was not at odds with the automatic stay provision of the Code.

In its holding, the Eleventh Circuit noted "[i]n bankruptcy, the limitations period provides a bright line for debt collectors and consumer debtors, signifying a time when the debtor's right to be free of stale claims comes to prevail over a creditor's right to legally enforce a debt. A Chapter 13 debtor's memory of a stale debt may have faded and personal records documenting the debt may have vanished, making it difficult for a consumer debtor to defend against the time-barred claim." Using a "least sophisticated" consumer test, the Court held the "least sophisticated" Chapter 13 debtor may be unaware a claim is time barred and unenforceable and thus fail to object to such claim. Therefore, the filing of a time-barred claim in bankruptcy was "deceptive," "misleading," "unconscionable," or "unfair" under the FDCPA.

Avoidance Actions.

***State Bank of Toulon v. Covey (In Re Duckworth)*, 2014 U.S. App. Lexis 22054 (7th Cir. 2014).** In this recent case, decided November 21, 2014 by the Seventh Circuit (Hamilton), the Court held mistaken identification of a debt to be secured cannot be corrected, against a bankruptcy trustee, by using parole evidence to show the intent of the parties to the original loan.

On December 15, 2008, the debtor borrowed $1.1 million from the bank. The Note was dated and signed on December 15, 2008. The Agricultural Security Agreement was dated two days earlier, December 13, 2008. The Security Agreement said it secured a Note "in the principal amount of $_____ dated December 13, 2008". There was no promissory note dated December 13, 2008. The bank prepared the documentation.

The bankruptcy court held the mistaken date in the Security Agreement did not defeat the bank's security interest and that the Security Agreement of December 13 secured the Note of December 15. The district court affirmed.

The issue before the Seventh Circuit was specifically whether the mistaken date in the Security Agreement defeated the bank's asserted security interest in the collateral granted to it. The bank argued the Security Agreement is enforceable against the debtor as the original borrower and should also be enforceable against the trustee. Unfortunately for the bank, the Court read the terms of the Security Agreement and concluded it cannot be construed to secure the December 15 Note. Noting parole evidence could have supported reformation of the Security Agreement as between the debtor and the bank, the evidence cannot be used against the bankruptcy trustee. The Security Agreement clearly referred to a December 13 Note the parties agreed never existed.

The bank asserted it could rely on a "related documents" provision to incorporate the December 15 Note. It argued the Security Agreement defines related documents as all those documents executed in connection with the indebtedness. The indebtedness is defined, in turn, as a debt evidenced by the Note or related documents. The Court found the argument was circular reasoning and did not allow the bank to "escape from the mistaken date."

The bank primarily relied on parole evidence from outside the four corners of the document to interpret what the parties really intended. While the Court is "confident that the bank would have been able to obtain reformation – even of an unambiguous agreement – against the original borrower if he had tried to avoid the Security Agreement based on a mistaken date," it found a bankruptcy trustee is in a different position. A bankruptcy trustee is tasked with maximizing the recovery for unsecured creditors. Trustees may exercise their "strong arm powers" and one of them is that the trustee is deemed to be in the privileged position of a hypothetical subsequent creditor and can avoid any interest a hypothetical Section 544 creditor could avoid without regard to any knowledge of the trustee of any creditor. The Court refers to the strong arm power as a "blunt information generating tool" that encourages lenders to give public notice of their security interests by harshly penalizing those fail to do so.

The bank attempted to argue constructive notice be imputed to the trustee even if using the strong arm power. However, the concept of constructive notice comes from state real property law and defines property rights of good faith purchasers. Good faith purchasers cannot avoid the claims of creditors that comply with state recording laws that provide public notice of ownership of and liens in property and such notice would constrain a trustee who seeks to use his specific strong arm power of a good faith purchaser of property.

The Court, however, found the trustee was not using that particular strong arm power and each subsection of the statute stood separately without reference to another. The trustee was acting as a hypothetical judicial lien creditor under Section 544(a)(1), not a good faith purchase under 544(a)(3).

The 7th Circuit, in its characteristically economic analysis, emphasizes the importance of a third party's ability to rely on unambiguous documents. It advocates a rigid rule which would allow later lenders to rely on the face of unambiguous security agreements without having to worry that a prior lender might offer parole evidence. It refers to its prior decision in *In Re Martin Grinding*, 763 F.2d. 596, and further looks to the First Circuit's decision in *Safe Deposit Bank and Trust Company v. Berman*, 363 F.2d. 401. In that case, there was a mistake in identifying debts to be secured. The mistake was held against the lender even though reluctantly by the First Circuit which indicated:

> [t]he result is commanded, not by fireside equities, but by the necessary technicalities inherent in any law governing commercial transactions…in a commercial world dependent upon the necessity to rely upon documents meaning what they say, the explicit recitals on forms, without requiring for their correct interpretation other documents not referred to, would seem to be a dominate consideration.

The bank, in a final act of desperation, argued the Court should simply overlook the erroneous date in the Security Agreement because it was just a *small error* that would have been easy to discover. Naturally, the Court did not buy this.

11 U.S.C. § 523 – Discharge of Taxes.

***In re Vaughn*, 765 F.3d 1174 (10th Cir. 2014).** *Vaughn* is a good reminder of the risks associated with aggressive tax planning. The debtor was the former CEO of FrontierVision Partners, LP. In 1999, FrontierVision was sold for approximately $2.1 billion. Out of the sale, debtor received $20 million in cash and $11 million in the purchasing company's stock. Realizing he would need tax planning assistance, prior to the sale closing, the debtor met with a KPMG LLP partner who introduced him to a tax strategy known as Bond Linked Issue Premium Structure ("BLIPS") which created a desired tax loss to offset a participant's actual economic gain, thereby sheltering the gain from tax by using a structured, multi-stage program involving investment in foreign currencies. KPMG LLP advised the debtor of the potential risks associated with BLIPS and possible challenges by the IRS. After the FrontierVision sale closed, the debtor participated in a BLIPS transaction which resulted in a purported tax loss of approximately $42

million, sufficient to offset the capital gains generated from the sale on his 1999 tax return.

In September, 2000, the IRS issued Internal Revenue Bulletin Notice 2000-44 which discussed transactions in the nature of the BLIPS entered into by the debtor. The notice stated the purported losses from such transaction were not allowable as deductions for federal tax purposes because they did not represent bona fide losses. KPMG notified all of its BLIPS clients, including the debtor, of this Notice in February, 2001.

Subsequent to receipt of this notice, the debtor and his wife separated and the debtor began a relationship with another woman. He purchased a $1.73 million home which he titled in her name and a new BMW. After his divorce and property settlement were final, he married her and established an irrevocable trust for her daughter into which he put $1.5 million. During the year and a half marriage, they lived a lavish lifestyle. As a result of the property settlement in his second divorce, he retained a townhome (by then worth half of the purchase price due to flood damage), a pickup truck, a 2002 Chevy Trailblazer and the remaining balance in the brokerage account, which totaled less than the $3.5 million received by his second wife.

Immediately prior to his second divorce, the IRS notified the debtor his first wife had filed a request for innocent spouse relief with respect to their 1999 tax return. The debtor also filed a request on the grounds that, due to the inequitable division of assets, he lacked sufficient assets to pay the deficiencies owed as a result of the BLIPS.

The debtor amended his 1999 tax return and in June 2004, the IRS notified the debtor of an approximately $8.6 million tax deficiency arising from the IRS's determination the debtor had overstated his losses as a result of his BLIPS participation. It also notified the debtor of an additional $120,000 deficiency arising out of his 2000 tax return. By the time the IRS filed its proof of claim in the debtor's bankruptcy case in December, 2006, its claim had grown to $14,359,592.

The debtor filed an adversary proceeding under 11 U.S.C. § 523(a)(1)(C) seeking a determination the taxes assessed for years 1999 and 2000 were discharged in his Chapter 11 bankruptcy case. Finding the debtor both filed a fraudulent tax return and willfully evaded his taxes, the bankruptcy court held the debt owed to the IRS non-dischargeable. The debtor appealed to the district court which upheld the bankruptcy court's decision concerning the debtor's willful attempt to evade his 1999 and 2000 tax obligations but declined to consider the bankruptcy court's alternative ruling.

The debtor raised two questions in his appeal to the Tenth Circuit. First, he argued the district court improperly failed to determine whether the evidence before the bankruptcy court satisfied the two discrete elements of willful evasion, i.e., the conduct requirement as well as the mental state requirement. Finding the bankruptcy court properly applied the two-element approach, the Tenth Circuit affirmed the bankruptcy court's ruling. (Because its review is of the bankruptcy court's decision, not the district court's decision, the Tenth Circuit determined it need not decide if the district court's so-called "holistic" review of the evidence was appropriate.)

The debtor further argued the bankruptcy court's decision was improperly based on findings of fact which constituted mere negligent conduct, rather, than the requisite willful conduct and essentially asked the Tenth Circuit to reweigh the evidence. Noting it reviews the factual findings under the clearly erroneous standard, the Tenth Circuit ruled the bankruptcy court's factual findings supported its decision.

Breach of Contract.

***In re Central States Mechanical, Inc.*, 556 Fed. Appx. 762 (10th Cir. 2014).** Central States Mechanical, Inc. contracted with Agra Industries, Inc. to install mechanical systems in two biofuel plants in Iowa. Central States completed work at one plant but discontinued work at the second plant before the job is finished. After declaring bankruptcy, Central States sued Agra for damages arising from both projects. In particular, Central States claimed over $1 million in damages and costs of work on the completed project related to changes in the scope of the project and over $3 million in the costs for work and demobilization costs on the second project.

After trial in the bankruptcy court, Central States, although winning several of its claims under the first contract, was found to have materially breached the second contract when it discontinued work without proper cause. On the counterclaim by Agra, the bankruptcy court allowed $3 million for Central States' breach of contract. Central States appealed to the district court, which affirmed the bankruptcy court's decision. Central States appealed to the Tenth Circuit.

The Tenth Circuit (Tymkovich), in affirming the decisions of the district court and the bankruptcy court performed a fairly straightforward analysis of contract law. Central States' first claim was that Agra materially breached the contract by failing to timely approve change orders or to notify Central States its subcontractor was causing delays. The Court noted the bankruptcy court found it was "apparent that Central States performed the work before it submitted the change orders and attempted paper up the change order after the fact." Under Iowa law, to determine whether breach is material, five factors are relevant: (1) the extent to which the injured party is deprived of the benefit it expected; (2) the extent to which the injured party can be adequately compensated for the loss; (3) extent to which the party failing to perform will suffer forfeiture; (4) the likelihood the party failing to perform will cure his failure; and (5) the extent to which the behavior of the party failing to perform comports with standards of good faith and fair dealing. Central States claimed Agra's delays and failure to inform it of the subcontractors' delays deprived it of its ability to continue working on schedule without additional costs or unanticipated work. Looking to the contract, the Court held Central States was not obligated to perform out of scope work or incur extra costs and it did at its own peril.

Next, Central States argued compliance with the claims provisions for changes under the contract should be excused because compliance would be impracticable or futile. Unfortunately for Central States, the bankruptcy court found Agra "assisted and encouraged Central in submitting delay claims", in effect, that Agra never "sandbagged" Central States in order to get it to perform out of sequence work.

Central States also argued Agra waived the necessity for written changes to the claims by its conduct. Once again, and unfortunately for Central States, waiver is generally a question of fact especially where predicated on acts or conduct. The Iowa rule is that "recovery can be had for extra work only if it was performed with the knowledge or consent of the adverse party". The bankruptcy court found Agra helped Central States submit delayed claims which, in itself, evidenced Agra's intent that Central States comply with the change order provisions. It found no evidence Agra "directed Central States to proceed without an approved change order or agreed, verbally or in writing, to pay Central States for out of sequence work."

Finally, Central States argued Agra was unjustly enriched and, therefore, it should be compensated on the *quantum meruit* theory. Once again, the Court set forth the elements of this theory as: (1) services were provided under such circumstances as to give the recipient reason to understand that (a) the services were being performed for the recipient and not some other person and (b) the services were not rendered gratuitously but with the expectation of compensation for the recipient; and (2) the services were beneficial to the recipient. But, courts will not imply a contract where an express contract exists covering the same subject matter. The Court found to the extent the claim for quantum meruit is covered by the express contract, Central States cannot state a claim under quantum meruit.

On the counterclaim, the Court agreed with the district court that Central States was not entitled to suspend performance on the second contract. This again turned on the facts of the case. It did not show material breach under the contract based on Agra's delays in payment as Central States did not comply with the notice and claim procedures under the contract. Additionally, Agra was not found to have violated the implied covenant of good faith and fair dealing which, in the context of a construction contract, is articulated as "the person for whom the work is contracted to be done will not obstruct, hinder, or delay the contractor, but, on the contrary, will always facilitate the performance of the work to be done by him." The facts simply do not come close to a violation of this implied covenant.

The Court further upheld the bankruptcy court's methodology in determining damages for the breach by Central States and, finally, despite Central States having prevailed to some extent, it agreed with the bankruptcy court that it was not entitled to an award of attorney's fees because it was not the substantially prevailing party on its damages claims in light of the massive counterclaim which was awarded against it.

Post-confirmation Debtor.

***ASARCO LLC v. Union Pacific R. Co.*, 755 F.3d 1183 (10th Cir. 2014).** This case arises out the reorganized debtor's efforts to recover contribution under CERCLA against two potentially responsible persons. Prior to its bankruptcy filing, the EPA brought an action under CERCLA against ASARCO. During the pendency of that action, ASARCO filed its Chapter 11 bankruptcy case. In 2009, ASARCO and the EPA reached a settlement which was approved by the bankruptcy court on June 5, 2009. Significant to this appeal, the settlement agreement was not conditioned upon confirmation of any particular plan of reorganization. In November, 2009, ASARCO's plan of reorganization was confirmed and became effective on December 9, 2009.

On December 10, 2012, ASARCO filed suit against Union Pacific and Pepsi seeking contribution and asserting two claims: one a direct contribution claim; the second a contribution claim as debtor ASARCO's subrogee. The defendants both filed motions to dismiss.

In recommending dismissal, the magistrate judge concluded the direct contribution claim was time barred by the 3-year statute of limitations set forth in CERCLA, relying on the June 5, 2009 order approving the ASARCO/EPA settlement in the bankruptcy case. The magistrate judge also recommended dismissal of the subrogated contribution claim because, based on the definitions of "Debtor" and "Reorganized Asarco" set forth in the confirmed plan, the Debtor and Reorganized ASARCO were not separate legal entities for the purpose of pursuing post-confirmation subrogation claims. The district court adopted the magistrate judge's recommendation *in toto* and dismissed the complaint in its entirety.

ASARCO appealed advancing two arguments. First, it asserted the magistrate judge and the district court erred when they determined the bankruptcy court's June 5, 2009 order approving the settlement constituted "a final judicially approved settlement" because ASARCO claimed that approval was merely preliminary and subject to the confirmation process. According to ASARCO, at the time of the June 5, 2009 order, "the amount of the payable claim was not set, and the party responsible for its payment was unknown." Rather, ASARCO argued, the settlement did not become a final until the plan was confirmed and the actual payor was finally determined. The Tenth Circuit rejected ASARCO's argument relying on the plain language of the statute which clearly provides the statute of limitations begins on the "date of . . . entry of a judicially approved settlement with respect to such costs or damages." 42 U.S.C. § 9613(g)(3). Concluding the bankruptcy court's June 5, 2009 order approving the settlement constituted the requisite "judicially approved settlement," the statute of limitations began running as of that date.

ASARCO also complained the district court erred when it held reorganized ASARCO was not a subrogee of debtor ASARCO because the district court was wrong in holding reorganized ASARCO and debtor ASARCO were the same entity. Subrogation is defined as the substitution of one party for another whose debts the party pays, entitling the paying party to the rights and remedies of the debtor. Subrogation is not applicable if the party is paying its own debt rather than another's obligation. Review of the confirmed plan, however, demonstrated debtor ASARCO and reorganized ASARCO were, in fact, the same entity. Accordingly, the Tenth Circuit affirmed the dismissal of the case.

Chapter 12 – Eligibility.

***In re Woods*, 743 F.3d 689 (10th Cir. 2014).** The Tenth Circuit addressed the requirements to be a "family farmer" for purposes of Chapter 12 eligibility. A "family farmer" is defined as an individual or individuals "not less than 50 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such

individual and spouse . . . 11 U.S.C. § 101(18)(A).

The debtors purchased farmland on which they ran their hay-farming operation. Over time, the debtors accumulated various debts, some of which were related to their farming operation; others which were not. The debt at the center of the controversy was a $480,000 loan. Approximately $284,000 of the loan proceeds were used to pay off the loan used to acquire the farmland. The parties agree that portion of the debt arises out of a farming operation. The remainder of the loan proceeds was used to construct the debtors' residence on the farmland (the so-called "Construction Loan").

The objecting lender argued the Construction Loan was not "debt arising out of a farming operation." If the Construction Loan was excluded, then the debtors would not meet the 50 percent test and would be ineligible for relief under Chapter 12. The bankruptcy court disagreed, finding the residence was "an integral part of the farm operation." The BAP affirmed.

The Tenth Circuit disagreed. After carefully reviewing the language of 11 U.S.C. § 101(18)(A), it concluded the statutory term "arises out of" in the exception to the fifty-percent-farm-debt rule embodies a "direct-and-substantial-connection" standard. While courts have developed three tests to determine whether debt "arises out of" a farming operation – the "but-for" test, the "some-connection" test, and the "direct-use" test – the Tenth Circuit held the "direct-use" test was the appropriate test as it embodied the direct-and-substantial-connection standard by which the use must be view. This test is hinges on whether the loan proceeds were directly applied to or utilized in a farming operation and requires a court to look at the question in an objective, focused manner. Because the bankruptcy court improperly applied the "some-connection" test, the Tenth Circuit vacated the bankruptcy court's judgment and remanded the matter back to the bankruptcy court.

Ethics and Rule 9011 Sanctions.

***In re Hood*, 727 F.3d 1360 (11th Cir. 2013).** In *In re Hood*, John Hood met with Adrian Reyes of the Torrens Law Firm (the "Appellants") to discuss foreclosure defense services provided by the firm. Allegedly, Hood was considering hiring the firm to avoid state-court foreclosure proceedings of his Hollywood, Florida business. On February 21, 2012, Hood, unable to afford representation in both the foreclosure proceeding and the fee for bankruptcy services, paid a $1,000.00 retainer to the firm to provide foreclosure defense work. On the same day, a courier filed a Chapter 13 petition via power of attorney on Hood's behalf. The circumstances surrounding the petition's preparation and filing were highly disputed.

Hood contended he had no knowledge the bankruptcy was filed. The bankruptcy court found Hood to be untruthful, but still held the Appellants fraudulently prepared and filed the pro se petition on behalf of Hood. The Appellants' argument was the firm's secretary merely acted as a scrivener when she prepared the petition at Hood's request. Nevertheless, the bankruptcy court found the Appellants acted as ghostwriters by failing to sign the Chapter 13 petition, and thus perpetrated fraud on the court. On appeal, the district court affirmed the bankruptcy court's decision.

On further appeal to the Eleventh Circuit, the bankruptcy court's decision was reversed and remanded. The Eleventh Circuit looked narrowly at the language of Rule 4-1.2(c) of the Florida Rules of Professional Conduct, which prohibits ghostwriting. It narrowly interpreted the phrase "drafting," defining it as "to write or compose" and held the Appellants' recording of Hood's answers was not "drafting" within the meaning of the rule. The Eleventh Circuit also cited to a Second Circuit case, *Liu*, where that court held a petition prepared by undisclosed counsel was "unlikely to have caused any confusion of prejudice," and held there to be no fraud or violation the local rules.

***Smith v. Robbins (In re IFS Financial Corp.)*, No. 02-39553 (S.D. Tex. Aug. 11, 2014) (Hughes, J.).** The Chapter 7 trustee billed an estate for a four-night, family trip to New Orleans for a total of $3,486.37. The bankruptcy court issued a show cause order as to why the trustee should not be removed from his duties pursuant to 11 U.S.C. § 324. The trustee testified he and his wife, whom he had hired as his counsel, traveled to New Orleans three days early to prepare for an appeal. The trustee also brought the couple's children along because the children had behavioral issues. The bankruptcy court found cause and, pursuant to 11 U.S.C. § 324(b), removed the trustee from the twelve cases in which he was a trustee.

The trustee appealed to the District Court, which affirmed the bankruptcy court, explaining the inquiry for removing a trustee is not about the trustee himself, but rather about the "integrity of the administration of estates in bankruptcy." The District Court found the trustee had "intentionally abused the public's trust" and "he [could] not be trusted."

***Young v. Young (In re Young)*, 507 B.R. 286 (B.A.P. 8th Cir. 2014) (Schermer, J.).** The debtor was not current on post-petition alimony payments, but his counsel amended his schedules and plan to treat the delinquent post-petition alimony as pre-petition priority debt and filed a false certification the debtor was current on post-petition alimony payments. The bankruptcy court issued an order to show cause as to why debtor's counsel should not be sanctioned pursuant to Rule 9011, in which order the bankruptcy court listed four bases upon which it was considering issuing sanctions. Under Rule 9011, the bankruptcy court suspended debtor's counsel from practice in the Arkansas bankruptcy court for six months, imposed a $1,000 fine, payable to the clerk of the court, and required twelve hours of continuing legal education on Chapter 13 bankruptcy to be completed within six months. The bankruptcy court also fined debtor's counsel an additional $1,000 and issued a concurrent six-month suspension from practice in the Arkansas bankruptcy court pursuant to 11 U.S.C. § 105 for mis-representations she made during her testimony at the hearing on the order to show cause. Debtor's counsel appealed.

The Eighth Circuit BAP affirmed the bankruptcy court's ruling under Rule 9011, explaining the bankruptcy court met the requirements of Rule 9011 by setting out four clear bases in the order to show cause upon which it was considering sanctions and finding the sanctions were appropriate because they were "limited to what [was] sufficient to deter repetition of such conduct or comparable conduct by others similarly situated." Rule 9011(c)(2). The BAP, however, reversed and remanded on the sanctions that arose from debtor's counsel's testimony at the hearing on the order to show cause. The BAP found debtor's counsel did not

have notice such sanctions would be imposed until the bankruptcy court had already imposed them.

Criminal Issues.

***U.S. v. Hale*, 762 F.3d 1214 (10th Cir. 2014).** The debtor challenged his convictions for lying under oath, attempting to conceal assets of the bankruptcy estate and for perpetrating a hoax regarding the transmission of a biological agent when he sent the trustee a package containing an unidentified substance with a note that read, "Possible Haz-mat? Termites or Hanta virus [sic] from mice?" In October, 2005, the debtor, an attorney with 20 years of bankruptcy experience, filed a Chapter 13 bankruptcy case. On Schedule A, he listed three parcels of real property. According to Schedule D, there was no equity in any of the three of the properties. In July, 2006, the debtor converted his case to a case under Chapter 7. During the first meeting of creditors, although questioned about the real property, the debtor did not divulge he had placed an ad in two newspapers offering to sell one of the properties for over twice the value shown on Schedule A. A few months later, the debtor entered into a real estate purchase contract which granted the debtor the right to rent a portion of the property for $300 per month for up to ten years. In preparing for the closing, the title company contacted the Chapter 7 trustee who immediately cancelled the sale. Later that day, the debtor twice visited the trustee's office, appearing "agitated and angry." A week later, the trustee entered into a new contract with the same purchaser at the same purchase price but without the lease. When the trustee sought approval of the sale, the debtor faxed a hand-written message to the title company promising a "full round of litigation at the very least." Six days after the bankruptcy court entered its order approving the sale, the debtor filed an emergency motion to dismiss his bankruptcy case which was denied. When the trustee began eviction proceedings for the property that was the subject of the sale order, she discovered the debtor had cancelled insurance and utility service to the other two properties.

During this time period, the debtor faxed handwritten messages to the trustee multiple times a day regarding a variety of issues surrounding the debtor's real property. One fax simply said "Please check out the possible haz-mat problem sent in an orange envelope today." The next day, the trustee received an orange envelope, listing the debtor's Utah property as a return address. Handwritten on the envelope was "Caution! Hand-cancel please!" Immediately upon receipt, the trustee contacted the police. After determining there were no explosives, radiation or volatile organic compounds, the envelope was opened by a member of the bomb squad. Inside was a sandwich baggy with an unidentified material, and a note that said "Possible Haz-mat? Termites or Hanta virus [sic] from mice?" (Hantavirus is a Class Three agent in the four-level classification of "bioterrorism type agents.") Evidence presented at trial indicated the debtor did not believe the envelope contained Hantavirus, however, the debtor told a friend "[i]t was just the way that . . . you do business" because the trustee was "playing hardball with him."

Following his conviction and sentencing, the debtor appealed. In challenging his perjury conviction he argued the trustee's questions during the 341 meeting were ambiguous because when she asked the debtor if the information in his schedules was true, accurate and complete, it was unclear whether the question pertained to the time the documents were executed or the time

when he was being questioned. Because the government focused on both time periods at trial, the Tenth Circuit agreed with the debtor that the question was ambiguous and, therefore, did not support a conviction for perjury.

The debtor also challenged his conviction for concealing the purchase agreement on the grounds the purchase agreement was void or, alternatively, the purchase agreement was not property of the bankruptcy estate. 18 U.S.C. § 152(1) prohibits a debtor from "knowingly and fraudulently conceal[ing] . . ., in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor." This conviction hinged on whether the real estate purchase contract was "property of the estate" under 11 U.S.C. § 541(a). The debtor argued the real estate purchase contract was void, however, the government maintained the contract was merely voidable, giving a trustee the "legal power, either of avoidance or of ratification, or of both." The Tenth Circuit agreed with the government and upheld the conviction.

Finally, the debtor complained about his conviction for perpetrating a hoax involving biological weapons, challenging the constitutionality of 18 U.S.C. § 175 and asserting the government failed to prove his actions were not for "peaceful purposes" within the meaning of 18 U.S.C. § 175. Focusing on the debtor's actions (claiming to send a deadly virus through the mail) and determining his actions were in retaliation of an official's discharge of her duties as an officer of the court, the Tenth Circuit upheld his conviction.

***Res Judicata*, Estoppel and Issue Preclusion.**

***In re Zwanziger*, 741 F.3d 74 (10th Cir. 2014).** This case provides a lesson in the importance of carefully considering the timing of a bankruptcy filing, particularly when there is pending litigation. The question before the Tenth Circuit was: does issue preclusion apply in bankruptcy court to a final determination in district court that a party waived an issue? Prior to his bankruptcy filing, the debtor was sued for fraud and violations of Oklahoma's wage law. After judgment was entered against the debtor, he appealed to the Tenth Circuit. While the jury verdict finding the debtor liable was upheld, the damage award was remanded to district court to be recalculated. In that earlier appeal, the Tenth Circuit noted because the plaintiffs failed to include damages for emotional distress in the final pretrial order, the district court erred when it instructed the jury to consider damages for emotional distress and remanded the case to the district court for a determination of damages. Significantly, before the district court addressed the question of damages, the debtor filed bankruptcy.

Plaintiffs filed an adversary proceeding seeking a determination of the amount of the debt to be excepted from the debtor's discharge. The bankruptcy court concluded the issue of liability for fraud had been finally decided but given the remand, damages remained to be determined. The bankruptcy court, believing it was not bound by the Tenth Circuit's remand instructions because it was merely determining the amount of the damages excepted from the debtor's discharge rather than determining the full amount of the damages, ruled $181,300, of which $50,000 was for emotional distress, was excepted from the debtor's discharge.

The debtor appealed the decision to the BAP, arguing *res judicata* precluded the bankruptcy court from including damages for emotional distress. In a split decision, the BAP reversed the bankruptcy court's ruling but held although *res judicata* (claim preclusion) was inapplicable, issue preclusion did apply and the bankruptcy court erred in ignoring the Tenth Circuit's earlier determination plaintiffs' failure to include a claim for emotional distress in the final pretrial order constituted a waiver of a claim for such damages. The dissent agreed with the majority that *res judicata* was inapplicable but rejected the majority's reliance on issue preclusion because the issue of emotional damages had never been fully adjudicated as required under the doctrine of issue preclusion.

Dissatisfied, plaintiffs appealed. The Tenth Circuit agreed with the dissent. Because a finding that an issue of fact or law was waived is not a decision on the merits, issue preclusion simply does not apply. Moreover, the Tenth Circuit held a waiver finding in one case is not the type of finding entitled to issue preclusion in another case. Except where waiver is imposed as a sanction, it is simply a procedural determination that governs only the case in which it is made. Had the debtor held off filing bankruptcy until after the district court recalculated the damages on remand, he would have had the benefit of the waiver ruling. By filing his bankruptcy case before the district court had ruled, however, he lost the benefit of the Tenth Circuit's earlier determination.

***Vehicle Market Research, Inc. v. Mitchell Intern., Inc.*, 767 F.3d 987 (10th Cir. 2014).** This case serves as a good reminder of the need to think about how one values assets in a bankruptcy case. Vehicle Market Research, Inc.'s ("VMR") sole owner (and alter-ego) valued his ownership interest in VMR as $0.00 in his personal bankruptcy filing. A few years later and as the bankruptcy case was winding up, VMR filed suit against Mitchell International, Inc. ("MI") seeking approximately $4.5 million in damages arising from the alleged misappropriation of VMR's materials and intellectual property exclusively licensed to MI. In granting MI's motion for summary judgment, the district court held VMR was judicially estopped from pursuing its action based on the inconsistency of VMR's sole owner's valuation of the VMR stock in his bankruptcy case.

Judicial estoppel generally applies when (1) a party takes a position clearly inconsistent with an earlier-taken position; (2) adopting the later, inconsistent, position would create an impression that either the earlier or the later court was misled; and (3) allowing the party to change their position would give them an unfair advantage. This doctrine, however, is to be applied narrowly and cautiously. Judicial estoppel rarely applies to opinions as they are not assertions of verifiable fact. An opinion about a value may often sound decisive but it is just an opinion and often a wish. Because the purportedly inconsistent statements were opinion, not fact, the Tenth Circuit reversed the district court's grant of summary judgment on judicial estoppel grounds and remanded the case back to the district court.

Rule 60(b) Motions to Dismiss.

***Wortley v. Chrispus Venture Capital, LLC (In re Global Energies, LLC),* Case No. 13-60163-Civ-Williams (Jun. 17, 2014).** The *Wortley* case came before the Eleventh Circuit on

appeal from a bankruptcy court order denying a motion for reconsideration under Fed.R.Civ.P. 60(b). Prior to the underlying bankruptcy case's filing, Joseph Wortley, James Juranitch, and Richard Tarrant shared ownership in a company called Global Energies, LLC ("Global"). Wortley and Juranitch personally owned their stakes, while Tarrant held his through Chrispus Venture Capital, LLC ("CVC"). Global was created to market a plasma technology developed by Juranitch.

In mid-2010, after a number of business disagreements, Tarrant and Juranitch developed a plan to wrest Wortley's interest in Global Energies from him by having CVC file an involuntary bankruptcy petition against Global Energies. The involuntary petition was filed on July 1, 2010, and CVC was the petitioning creditor. Wortley eventually began to suspect collusion by Tarrant and Juranitch, and he moved to dismiss the case as having been filed in bad faith. The bankruptcy court held an evidentiary hearing, and at that point, Wortley could only proffer circumstantial evidence. Importantly, CVC did not turn over relevant emails requested in discovery, despite having been requested. CVC's counsel, Craig Pugatch, represented to the bankruptcy court that all responsive documents had been produced. As the Eleventh Circuit noted, "[h]e asserted no privilege that would have allowed [CVC] to withhold the missing emails or put Wortley on notice that the emails existed." Further weakening Wortley's case, Tarrant and Juranitch gave sworn testimony denying their plan to file the involuntary. Pugatch ratified these statements to the court, despite knowing better. Without direct evidence, Wortley withdrew his motion to dismiss without prejudice.

About a year later, Worley renewed his motion to dismiss based on new evidence. He identified emails between Tarrant and Juranitch that appeared to show they had colluded to do business without him before filing bankruptcy. As was the case with the old evidence, the new evidence gathered by Wortley only circumstantially supported the claim that CVC filed the involuntary petition in bad faith.

Finally, through ongoing state court litigation, Worley obtained the withheld emails showing Juranitch and Tarrant colluded to file the involuntary bankruptcy. These emails came from the attorney defendant Tarrant in state court, and the Court made a point to show they did not come from Pugatch, who had actually received the emails. Based upon the new evidence, Wortley filed a Rule 60(b) motion for reconsideration which was summarily dismissed by the bankruptcy court. The denial of the Rule 60(b) motion was affirmed by the district court and Wortley appealed.

On appeal, the Eleventh Circuit reversed the lower courts and remanded the case, consistent with its directives. The Eleventh Circuit held the bankruptcy court applied the wrong legal standard and abused its discretion by doing so. It found Worley had met his burden for a Rule 60(b) motion and held the bankruptcy court should grant that motion and vacate its order approving the sale of Global's assets to CVC. Importantly, in its holding, the Court noted the bad faith of Tarrant and Juranitch, under any of the established tests. Additionally, the Court chided Pugatch for his role suborning perjury, orchestrating the involuntary, and committing discovery abuses. For these actions, the Eleventh Circuit directed the bankruptcy court to hold hearings to determine whether sanctions would be appropriate against all three.

Marijuana.

***In re Rent-Rite Super Kegs West Ltd.*, 484 B.R. 799 (Bankr. D. Colo. 2012)(Tallman, J.).** The Debtor filed for Chapter 11 relief, and a creditor moved to dismiss the case under the "clean hands doctrine" and pursuant to 11 U.S.C. § 1112(b). The debtor owned a warehouse in Denver, Colorado, to which the creditor's security interest attached. Approximately twenty-five percent of the debtor's income was generated from rent received from tenants that cultivated marijuana in the warehouse. The Bankruptcy Court found the debtor's conduct violated the federal Controlled Substances Act, despite Colorado law legalizing the conduct. The Bankruptcy Court explained there is no conflict between the Controlled Substances Act and the Colorado laws legalizing marijuana because the Colorado laws "make it clear that their provisions apply to state law only," thus the Supremacy Clause is not implicated. The Bankruptcy Court noted the continuing violations put the creditor's collateral at risk because the Controlled Substances Act's forfeiture provision was triggered. (The automatic stay does not prevent governmental agencies from exercising the government's police powers.)

Based on the continuing violations of the Controlled Substances Act and the creditor's collateral being at risk, the Bankruptcy Court found the "clean hands doctrine" applied and the debtor's criminal activity under federal law constituted cause pursuant to 11 U.S.C. § 1112(b) to determine whether the case should be dismissed or converted. The Bankruptcy Court further noted there was no possibility of the debtor confirming a plan as its income was derived from a "means forbidden by law." 11 U.S.C. § 1129(a)(3).

***In re Arenas*, 514 B.R. 887 (Bankr. D. Colo. 2014)(Tallman, J.)** Frank and Sarah Arenas filed for Chapter 7 relief and later moved to convert their case to one under Chapter 13. The United States Trustee moved to dismiss the case pursuant to 11 U.S.C. § 707(a). Mr. Arenas was in the business of producing and distributing marijuana, and the debtors jointly owned a commercial property in Denver, Colorado, part of which they leased to a marijuana dispensary. The Bankruptcy Court found the debtors were in violation of the Controlled Substances Act, and administration of the case was impossible. The Bankruptcy Court explained "the Debtors' chapter 7 trustee [could not] take control of the Debtors' Property without himself violating [provisions of the Controlled Substances Act]. Nor [could] he liquidate the inventory of marijuana plants Mr. Arenas possessed on the petition date because that would involve him in the distribution of a Schedule I controlled substance [(i.e., marijuana)]." The Bankruptcy Court found cause to convert or dismiss and, in assessing the debtors' motion to convert, it determined that under *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007), the case could not be converted due to the debtors' bad faith. The Bankruptcy Court did not find the debtors were acting subjectively in bad faith; rather it referred to an objective bad faith, explaining that because the source of the debtors' income was one "forbidden by law," they could not propose a confirmable Chapter 13 plan under 11 U.S.C. §1325(a)(3).