

42nd Annual Alexander L. Paskay Memorial Bankruptcy Seminar

Case Law Update

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PLENARY SESSION: CASE LAW UPDATE

Panelists

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PRIMARY TOPICS:

- Circuit split on whether certain garnished wages (collected during the 90-day "preference period" are avoidable transfers under the Bankruptcy Code – petition for cert docketed and filed by 5th Cir: NOTE – CERT WAS DENIED DEC. 4, 2017
 - a. *Matter of Jackson*, 850 F.3d 816 (5th Cir. 2017).
- 2. 11th Circuit's new standard for judicial estoppel:
 - a. *Slater v. United States Steel Corp.*, 2017 WL 4110047 (11th Cir. September 8, 2017) (12-15548) (en banc)
 - i. "We hold today that when determining whether a plaintiff who failed to disclose a civil lawsuit in bankruptcy filings intended to make a mockery of the judicial system, a district court should consider all the facts and circumstances of the case ... voluntariness alone does not necessarily establish a calculated attempt to undermine the judicial process."
- 3. 11th Cir decision in *In re Fundamental Long Term Care, Inc.*, 873 F.3d 1325 (11th Cir. 2017).
 - a. Permanent injunction to prevent judgment creditors from pursuing state court actions to collect on their judgments from alleged participant in purported "bust-out scheme" was authorized under exceptions to Anti-Injunction Act.
 - b. As part of settlement of "clawback" claims, court had jurisdiction to permanently enjoin state court judgment creditors from pursuing state law fraudulent transfer claims that arose out of the same nucleus of operative fact against alleged participant in purported "bust out scheme".
- 4. Petition for cert denied on October 30, 2017 in *O'Grady v. Birenbaum (In re Birenbaum)*, 691 Fed. Appx. 155 (5th Cir. 2017) requesting SCOTUS clarify the scope of its recent fraud ruling in *Husky International Electronics v. Ritz*, 136 S. Ct. 1581 (2016), in which SCOTUS said that the term "actual fraud" in section 523(a)(2)(A) includes forms of fraud, such as fraudulent-conveyance schemes, that can be carried out without a false representation.
- 5. Entz-White Lumber overruled by 9th Cir:
 - a. *In re New Investments, Inc.*, 840 F.3d 1137 (9th Cir. 2016) (holding that if state law and the parties' agreement requirement payment of a default rate of interest,

any "cure" under a Chapter 11 plan must provide for the same default rate of interest and/or any fees or penalties that must be paid under state law to cure and reinstate the loan).

6. Homestead and residency

- a. *In re Oyola*, 571 B.R. 874 (Bankr. M.D. Fla. 2017) (J. Williamson)
 - i. Chapter 7 debtor, a Colombian citizen who was not a permanent resident of the United States as of the petition date, claimed a Florida homestead exemption in the house in which she resided with her adult daughter, who was a permanent resident as of the petition date, and her minor granddaughter, a U.S. citizen.
 - ii. Even if Debtor, as a nonpermanent resident as of the petition date, could not legally intend to reside here permanently, she was living as a "family in fact" with her daughter and granddaughter, and so intended to make her home her family's permanent residence, such that she could claim the Florida homestead exemption.
 - iii. "Because the Florida Constitution permits an owner to claim property as homestead if the owner's family is living on the property, the Debtor is entitled to claim the homestead exemption."
- 7. Surrender decisions in the 11th Cir.
 - a. Failla v. Citibank, N.A. (In re Failla), 838 F.3d 1170 (11th Cir. 2016)
 - Debtors who file a statement of intent to surrender the property that collateralizes secured debt must perform that intent by surrendering the property both to trustee and to creditor;
 - ii. To "surrender" real property securing residential mortgage debt, in accordance with their stated intent, Chapter 7 debtors had to drop their opposition to state court foreclosure action; and
 - iii. Bankruptcy judge had authority to remedy debtors' abuse of bankruptcy process by directing debtors to withdraw their affirmative defenses and dismiss their counterclaim in state court foreclosure action.
 - b. In re Ayala, 568 B.R. 870 (Bankr. M.D. Fla. 2017) (J. Colton decision)

- i. Mortgagee moved to reopen closed Chapter 7 case in order to enforce debtor-mortgagors' state decision to "surrender" mortgage property.
- ii. Motion denied "Cause" did not exist to reopen a Chapter 7 case that had been closed years earlier, in order to permit mortgagee which had not declared a default or sought to foreclose until well after the case was closed, and which had accepted at least some of the postbankruptcy payments made by debtor-mortgagors, to enforce debtors' state intent to "surrender" mortgage property.
- 8. Jevic Holdings (Fentrice) structured dismissal case
- 9. Attorney client privilege decisions
 - a. In re Fundamental Long Term Care, Inc., 489 B.R. 451 (Bankr. M.D. Fla. 2013)
 - b. In re Fundamental Long Term Care, Inc., 493 B.R. 620 (Bankr. M.D. Fla. 2013)
 - c. In re Fundamental Long Term Care, Inc., 509 B.R. 956 (Bankr. M.D. Fla. 2014)
 - d. In re Fundamental Long Term Care, Inc., 515 B.R. 857 (Bankr. M.D. Fla. 2014)

SECONDARY TOPICS:

- 10. SCOTUS to rule on scope of the **safe harbor provision** in section 546(e).
 - a. Petition for cert granted in *Merit Management Group, LP v. FTI Consulting, Inc.*, 137 S. Ct. 2092 (2017).
- 11. SCOTUS to rule on the recharacterization of debt whether federal or state law applies to a recharacterization analysis.
- 12. Standard of review for determining a creditor's insider status in Chapter 11 reorganizations.
- 13. Circuit split on Chapter 11 cram-downs
- 14. Bankruptcy court's jurisdiction over Medicare claims 11th Circuit affirms district court's reversal of bankruptcy court.
 - a. *In re Bayou Shores SNF, LLC*, 828 F.3d 1297 (11th Cir. 2016)
 - b. Cert denied on split between 9th and 11th Circuit
- 15. Petition for cert. docketed for *In re Sunnyslope Housing Limited Partnership*, 859 F.3d 637 (9th Cir. 2017)

- 16. Petition for cert. denied in Chapter 7 case preventing debtor from discharging an attorney fee award obtained by his ex-wife during their divorce proceedings as a nondischargeable domestic support obligation.
 - a. In the Matter of McCloskey, 659 Fed.Appx. 196 (5th Cir. 2016), cert denied, 2017
 WL 1807373 (October 2, 2017).
- 17. Recent case holding that fee cap for committee counsel in DIP financing order does not apply when plan of reorganization is confirmed.
 - a. *In re Molycorp., Inc.*, 562 B.R. 67 (Bankr. D. Del. 2017)
 - i. "[A]bsent specific language not found in the DIP financing order at issue here, a dollar-amount cap on professionals' fee payment, or a carve-out, does not come into play once a Chapter 11 plan is confirmed. That is because a fundamental statutory requirement of the Bankruptcy Code is that, unless the holder of a particular claim has agreed to a different treatment, allowed professionals' fees are administrative expenses that need to be paid in full under any confirmed plan."
- 18. Prepackaged bankruptcy plan with all time requirements for confirmation done prior to confirmation; noticing can run from pre-petition date 28 days pre-petition
 - a. *In re Roust Corp.*, No. 16-23786, reorganization plan confirmed (Bankr. S.D.N.Y. Jan. 10, 2017).
 - b. https://www.csbankruptcyblog.com/2017/02/articles/bankruptcy/re-roust-seven-steps-confirming-plan-seven-days/
 - c. https://www.law360.com/articles/878594/vodka-maker-roust-gets-prepackaged-ch-11-plan-approved
 - d. http://www.shearman.com/en/newsinsights/publications/2017/01/roust-confirmation-plan-in-southern-district-of-ny
- 19. Assumption or rejection prior to confirmation (Post-effective date assumption or rejection)
 - a. Recent case *Triangle USA Petroleum Corp.*, docket number 16-11566 (holding that the debtors' plan sufficiently provided for the rejection of certain pipeline contracts, even though the rejection was conditioned upon the occurrence of future post-confirmation events).

Matter of Jackson, 850 F.3d 816 (2017)

77 Collier Bankr.Cas.2d 619, 63 Bankr.Ct.Dec. 231, Bankr. L. Rep. P 83,076

850 F.3d 816 United States Court of Appeals, Fifth Circuit.

In the MATTER OF: Christon JACKSON, Debtor Tower Credit, Incorporated, Appellant

Schott Appellee

Martin A. Schott, Appellee

No. 16-30274

FILED March 13, 2017

Synopsis

Background: Chapter 7 trustee brought adversary proceeding to recover wages that had been garnished prepetition, as representing preferential transfers of interest of debtor in property. The United States Bankruptcy Court for the Middle District of Louisiana, Douglas D. Dodd, J., granted trustee's motion for summary judgment, and creditor appealed. The District Court, John W. deGravelles, J., 550 B.R. 299, affirmed. Creditor appealed.

[Holding:] The Court of Appeals, James L. Dennis, Circuit Judge, held that transfer of Chapter 7 debtor's wages did not occur when garnishment order was served, more than 90 days prepetition, before debtor had even acquired interest in wages, but only as such an interest was acquired.

Affirmed.

West Headnotes (4)

[1] Bankruptcy

Conclusions of law; de novo review

Bankruptcy

Clear error

On appeal from district court's affirmance of judgment of bankruptcy court, the Court of Appeals applies same standard of review that district court applied, reviewing bankruptcy court's factual findings for clear error, and its legal conclusions and determinations on mixed questions of fact and law de novo. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[2] Bankruptcy

Mature of Transfer

Bankruptcy

When Transfer Occurs

What constitutes a transfer and when that transfer is complete, whether inside or outside 90-day preference period, is question of federal law. 11 U.S.C.A. § 547(b)(4)(A).

1 Cases that cite this headnote

[3] Federal Courts

Property

State law generally determines the nature of property interests involved in purported transfers, but only in absence of controlling federal law.

1 Cases that cite this headnote

[4] Bankruptcy

Judicial liens;garnishment, attachment, or execution

Transfer of Chapter 7 debtor's wages did not occur when garnishment order was served, more than 90 days prepetition, before debtor had even acquired interest in wages, but only as such an interest was acquired; accordingly, trustee was entitled to avoid, as preferences, wages that were paid over during preference period, despite creditor's contention that any transfer occurred outside preference-period when garnishment order was served. 11 U.S.C.A. § 547(b)(4)(A), (e)(3).

1 Cases that cite this headnote

Appeal from the United States District Court for the Middle District of Louisiana, John W. deGravelles, U.S. District Judge

Matter of Jackson, 850 F.3d 816 (2017)

77 Collier Bankr. Cas. 2d 619, 63 Bankr. Ct. Dec. 231, Bankr. L. Rep. P 83,076

Attorneys and Law Firms

Richard D. Bankston, Baton Rouge, LA, for Appellant.

Martin A. Schott, Pro Se.

Before DAVIS, DENNIS, and SOUTHWICK, Circuit Judges.

Opinion

JAMES L. DENNIS, Circuit Judge:

In 2009, Tower Credit, Incorporated, obtained a money judgment in a Louisiana state court against Christon Jackson. Seeking to collect, Tower obtained a garnishment order, served it on Jackson's employer on January 19, 2012, and began collecting Jackson's garnished wages. On November 17, 2012, Jackson filed for Chapter 7 bankruptcy protection in the United States Bankruptcy Court for the Middle District of Louisiana. The bankruptcy court appointed Martin Schott as trustee to administer Jackson's estate. In *818 2014, the trustee initiated this adversary action, seeking to void the garnishments collected by Tower within ninety days prior to Jackson's filing for bankruptcy as preferential transfers pursuant to 11 U.S.C. § 547(b). The trustee initially sought the return of \$2,034.81, but the parties have since stipulated that the actual amount at issue is \$1,756.04. The bankruptcy court ultimately granted summary judgment in favor of the trustee, and the district court affirmed on appeal. Tower timely appealed to this court, arguing that the garnished wages should be considered transferred on the date the garnishment order was served, before the preference period, and therefore that the trustee is not entitled to recover them. We disagree and therefore affirm.

DISCUSSION

[1] On appeal in a bankruptcy case, we apply the same standard of review that the district court applied: "[T]he bankruptcy court's factual findings are reviewed for clear error; its legal conclusions and mixed questions of fact and law, de novo." *In re Mercer*, 246 F.3d 391, 402 (5th Cir. 2001) (italics removed). Section 547(b) provides, in relevant part:

[T]he trustee may avoid any transfer of an interest of the debtor in property—

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- (3) made while the debtor was insolvent;
- (4) made—
 - (A) on or within 90 days before the date of the filing of the petition; ...
 - (B) ...
- (5) that enables such creditor to receive more than such creditor would receive if—
 - (A) the case were a case under chapter 7 of this title;
 - (B) the transfer had not been made; and
 - (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Tower contests only the fourth element, arguing that Jackson's interest in the garnished wages was transferred to Tower when it served the garnishment order on Jackson's employer, more than ninety days before the filing of Jackson's petition.

[3] "What constitutes a transfer and when it is complete is a matter of federal law." Barnhill v. Johnson, 503 U.S. 393, 397, 112 S.Ct. 1386, 118 L.Ed.2d 39 (1992) (citation and internal quotation marks omitted). State law generally determines the nature of property interests involved in purported transfers, but only "[i]n the absence of controlling federal law." See id. at 398, 112 S.Ct. 1386; see also Local Loan Co. v. Hunt, 292 U.S. 234, 243–45, 54 S.Ct. 695, 78 L.Ed. 1230 (1934) (declining to adhere to an Illinois state-law fiction that "an assignment of future wages creates a lien effective from the date of the assignment, which is not invalidated by the assignor's discharge in bankruptcy" and stating, "Local rules subversive [to the general purpose and policy of the bankruptcy act] cannot be accepted as controlling the action of a federal court.").

[4] Section 547(e) provides the governing principles that determine the timing of a transfer. As relevant to the instant case, a transfer is generally made at the time it is "perfected," § 547(e)(2)(B), which, in the context of

Matter of Jackson, 850 F.3d 816 (2017)

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non-real property, occurs when "a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee." § 547(e)(1)(B). However, § 547(e)(3) qualifies *819 that general principle and provides that "a transfer is not made until the debtor has acquired rights in the property transferred." See also In re Latham, 823 F.2d 108, 110 (5th Cir. 1987) (stating, "[A] lien that is perfected outside the preference period does not attach to property rights transferred to the Debtor during the preference period" and citing Tabita v. IRS, 38 B.R. 511, 513 (E.D. Pa. 1984) for the proposition that "wages earned within preference period are subject to preference even though writ of attachment was served beyond the preference period"). ¹

Tower contends that as soon as it served the garnishment order on Jackson's employer, no creditor on a simple contract could have acquired a judicial lien superior to Tower's interest. Thus, it argues that the transfer of the interest in Jackson's garnished wages was perfected at that time pursuant to § 547(e)(1)(B). That would be true, except for the additional instruction of § 547(e)(3), which requires the debtor to have rights in the property before any transfer can occur.

In Local Loan, the Supreme Court held, albeit in the context of a bankruptcy discharge dispute, "The earning power of an individual is the power to create property; but it is not translated into property within the meaning of the Bankruptcy Act until it has brought earnings into existence." 2 292 U.S. at 243, 54 S.Ct. 695. Thus, as the Sixth Circuit explained in *In re Morehead*, 249 F.3d 445, 448 (6th Cir. 2001), in the wage garnishment context, a debtor cannot logically obtain rights in her future wages until she performs the services that entitle her to receive those wages. 249 F.3d at 448. The Morehead court therefore held that "when wages are earned during the preference period, transfer of those wages pursuant to a garnishment order is avoidable under ... § 547(b)[]." *Id*. In other words, because Jackson had not earned the disputed wages before the ninety-day preference period, he had acquired no rights to those wages and, under § 547(e)(3), could not have transferred such rights to Tower prior to the preference period. See Morehead, 249 F.3d at 448; see also Local Loan, 292 U.S. at 243, 54 S.Ct. 695; Latham, 823 F.2d at 110.

Tower asserts that *Morehead* is "limited to states wherein the transfer does not occur when the garnishment is served." But it is federal law, not state law, that determines when the transfer occurred, Barnhill, 503 U.S. at 397, 112 S.Ct. 1386, and § 547(e)(3) requires that a debtor acquire rights in the property in question before any transfer is made. That is not to say that state law is never relevant to the application of § 547(e)(3); indeed, in the absence of controlling federal law, state law will determine whether the debtor had acquired rights in the property. See *820 Barnhill, 503 U.S. at 397, 112 S.Ct. 1386. There is controlling federal law in the context of a debtor's rights in future wages, however, and it provides that "[t]he earning power of an individual ... is not translated into property ... until it has brought earnings into existence." See Local loan, 292 U.S. at 243, 54 S.Ct. 695. Moreover, Tower has not even contended that Louisiana law provides employees with present rights in their unearned, future wages.

Tower cites three cases from the 1980s in which other circuits held that a transfer of garnished wages occurred at the time the garnishment was served on the employer. See In re Conner, 733 F.2d 1560 (11th Cir. 1984); In re Coppie, 728 F.2d 951 (7th Cir. 1984); *In re Riddervold*, 647 F.2d 342 (2d Cir. 1981). In *Conner*, the Eleventh Circuit relied on § 547(e)(1)(B) and held that, because no contract creditor could obtain a superior judicial lien after a garnishment was executed, the transfer occurred at the time of the execution. 733 F.2d at 1562. In Riddervold, the Second Circuit held that at the time the garnishment was executed it created a "continuing levy," which under New York law acted as a novation of all of the debtor's rights in his wages, and thus that there was no transfer during the preference period. 647 F.2d at 346. Importantly, neither Riddervold nor *Conner* even considered the effect of § 547(e)(3), and both predated Barnhill, in which the Supreme Court held that federal law governs the determination of whether and when a transfer occurred. See Morehead, 249 F.3d at 448– 49 (discussing and rejecting *Riddervold* and *Conner*).

In *Coppie*, the Seventh Circuit held, similar to *Riddervold*, that the execution of a garnishment acted as a novation of all of the debtor's interests in the wages under Indiana law so that there could not have been a transfer within the preference period. 728 F.2d at 953. Addressing § 547(e)(3), the court found it inapplicable because the debtor "will never acquire rights in the portion of his or her wages to be garnished in the future" as those were "irrevocably transferred to the garnishment plaintiff." *Id.*

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In our view, the *Coppie* court's conclusion that the debtor's rights in his future wages were "irrevocably transferred" at the time the garnishment order was entered conflicts with § 547(e)(3)'s instruction that no transfer of an interest in property is made before the debtor acquires rights in the property. Like *Conner* and *Riddervold*, *Coppie* predated *Barnhill*, and it appears that the Seventh Circuit itself no longer considers *Coppie*'s holding good law: that court subsequently concluded that pre-*Barnhill* cases holding that a transfer occurs when a notice of garnishment is served, including *Conner*, did not survive the Supreme Court's decision in *Barnhill*. *See In re Freedom Grp., Inc.*, 50 F.3d 408, 412 (7th Cir. 1995).

The trio of cases cited by Tower has been roundly criticized on the grounds discussed. See, e.g., Morehead, 249 F.3d at 448–49; Freedom Group, 50 F.3d at 412; In re White, 258 B.R. 129, 134 (Bankr. D.N.J. 2001); In re Mays, 256 B.R. 555, at 560 n.7; Tabita, 38 B.R. at 513; In re Dunn, 56 B.R. 275, 278 (Bankr. M.D. La. 1985); In re Perry, 48 B.R. 591, 598 (Bankr. M.D. Tenn. 1985); see also 5 Collier on Bankruptcy ¶ 547.05 (16th ed.) ("The analysis of these three appellate courts is wrong.... The timing scheme in section 547(e) does not exclude

garnishment liens. Until the debtor earns the wages, there is no property that the creditor can garnish or that the debtor can transfer. The creditor's right to the particular funds that are garnished exists only because the debtor is entitled to be paid those funds as wages; it does not exist unless the debtor first acquires the right to be paid."). We join the *821 other courts that have rejected the cases cited by Tower and decline to follow those cases.

The combination of Supreme Court precedent and the overwhelming weight of persuasive authority applying § 547(e)(3) make clear that a debtor's wages cannot be transferred until they are earned. Thus, we hold that a creditor's collection of garnished wages earned during the preference period is an avoidable transfer made during the preference period even if the garnishment was served prior to that period. We therefore AFFIRM the district court's judgment.

All Citations

850 F.3d 816, 77 Collier Bankr.Cas.2d 619, 63 Bankr.Ct.Dec. 231, Bankr. L. Rep. P 83,076

Footnotes

- 1 *Latham*'s favorable citation of *Tabita* for this proposition is arguably dicta, as *Latham* did not involve wage garnishment. *See* 823 F.2d at 109.
- The Bankruptcy Act was repealed in 1978 and replaced by the current Bankruptcy Code. See Bankruptcy Reform Act of 1978, 112 Stat. 2549, 2682. However, the Court in Local Loan grounded its holding in the purpose of the Bankruptcy Act to "relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." See 292 U.S. 234 at 244, 54 S.Ct. 695 (internal quotation marks omitted). This remains a primary purpose of the Bankruptcy Code as well, and the courts have continued to cite and apply Local Loan for this proposition. See, e.g., Grogan v. Garner, 498 U.S. 279, 286, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991); In re Shcolnik, 670 F.3d 624, 632 (5th Cir. 2012). We therefore conclude that Local Loan's holding that unearned, future wages are not property within the meaning of the bankruptcy laws remains valid and binding upon us.

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Slater v. United States Steel Corporation, 871 F.3d 1174 (2017)

2017 WL 4110047, 130 Fair Empl.Prac.Cas. (BNA) 727, 64 Bankr.Ct.Dec. 174...

871 F.3d 1174 United States Court of Appeals, Eleventh Circuit.

Sandra SLATER, Plaintiff-Appellant,

v.

UNITED STATES STEEL CORPORATION, Defendant-Appellee.

No. 12-15548 | (September 18, 2017)

Synopsis

Background: Former employee brought action against her former employer, alleging sex and race discrimination. After former employee filed Chapter 7 bankruptcy petition without listing discrimination action as unliquidated claim, the United States District Court for the Northern District of Alabama, Karon Owen Bowdre, J., 2012 WL 4478981, dismissed action under judicial estoppel doctrine. Former employee appealed. The Court of Appeals determined that judicial estoppel doctrine barred former employee's claims after employee failed to disclose those claims in her Chapter 7 bankruptcy petition. The Court of Appeals, 820 F.3d 1193, affirmed. Court of Appeals granted en banc review.

[Holding:] The Court of Appeals, Jill Pryor, Circuit Judge, held that district court had to consider all facts and circumstances of case to determine whether former employee by omitting civil claim in bankruptcy filing should be deemed to have intended to make mockery of judicial system, overruling *Barger v. City of Cartersville*, 348 F.3d 1289 and *Burnes v. Pemco Aeroplex, Inc.*, 291 F.3d 1282.

Remanded.

Ed Carnes, Chief Judge, filed concurring opinion.

West Headnotes (12)

[1] Bankruptcy

Creation of estate; time

When a debtor files a Chapter 7 petition, his assets, subject to certain exemptions, are immediately transferred to a bankruptcy estate. 11 U.S.C.A. § 541(a)(1).

Cases that cite this headnote

[2] Bankruptcy

Completion of plan; hardship

The debts of a Chapter 13 debtor are discharged if the debtor completes his payments under the plan. 11 U.S.C.A. § 1322(a)(1).

Cases that cite this headnote

[3] Bankruptcy

In general; standing

Bankruptcy

Effect

Because a Chapter 7 debtor forfeits his prepetition assets to the estate, only the Chapter 7 trustee, not the debtor, has standing to pursue a civil legal claim unless the trustee abandons the asset, which then returns the claim to the possession and control of the debtor. 11 U.S.C.A. § 541(a)(1).

Cases that cite this headnote

[4] Bankruptcy

In general; standing

Estoppel

Claim inconsistent with previous claim or position in general

A district court may apply judicial estoppel when the plaintiff (1) took a position under oath in the bankruptcy proceeding that was inconsistent with the plaintiff's pursuit of the civil lawsuit and (2) intended to make a mockery of the judicial system.

4 Cases that cite this headnote

[5] Federal Courts

Estoppel and waiver

Slater v. United States Steel Corporation, 871 F.3d 1174 (2017)

2017 WL 4110047, 130 Fair Empl.Prac.Cas. (BNA) 727, 64 Bankr.Ct.Dec. 174...

Because judicial estoppel is an equitable doctrine, a district court's decision to apply the doctrine is reviewed for abuse of discretion.

Cases that cite this headnote

[6] Estoppel

Claim inconsistent with previous claim or position in general

The equitable doctrine of judicial estoppel is intended to prevent the perversion of the judicial process and protect its integrity by prohibiting parties from deliberately changing positions according to the exigencies of the moment; when a party does so, the judicial estoppel doctrine allows a court to exercise its discretion to dismiss the party's claims.

Cases that cite this headnote

[7] Estoppel

Claim inconsistent with previous claim or position in general

A two-part test applies to guide district courts in applying judicial estoppel: whether (1) the party took an inconsistent position under oath in a separate proceeding, and (2) these inconsistent positions were calculated to make a mockery of the judicial system.

1 Cases that cite this headnote

[8] Estoppel

Claim inconsistent with previous claim or position in general

Under the two-part test used to guide district courts in applying judicial estoppel, a district court considers both the plaintiff's actions, i.e., whether he made inconsistent statements, and his motive, i.e., whether he intended to make a mockery of the judicial system; judicial estoppel should not be applied when the inconsistent positions were the result of inadvertence or mistake because judicial estoppel looks towards cold manipulation and not an unthinking or confused blunder.

1 Cases that cite this headnote

[9] Courts

Decisions in other circuits

Decisions of the former Fifth Circuit handed down before the close of business on September 30, 1981 are binding on the Eleventh Circuit Court of Appeals.

Cases that cite this headnote

[10] Bankruptcy

In general;standing

Estoppel

Claim inconsistent with previous claim or position in general

When determining whether a plaintiff who failed to disclose a civil lawsuit in bankruptcy filings intended to make a mockery of the judicial system, and therefore whether judicial estoppel should apply, a district court should consider all the facts and circumstances of the case; when the plaintiff's inconsistent statement comes in the form of an omission in bankruptcy disclosures, the court may consider such factors as the plaintiff's level of sophistication, whether and under what circumstances the plaintiff corrected the disclosures, whether the plaintiff told his bankruptcy attorney about the civil claims before filing the bankruptcy disclosures, whether the trustee or creditors were aware of the civil lawsuit or claims before the plaintiff amended the disclosures, whether the plaintiff identified other lawsuits to which he was party, and any findings or actions by the bankruptcy court after the omission was discovered; overruling Barger v. City of Cartersville, 348 F.3d 1289 and Burnes v. Pemco Aeroplex, Inc., 291 F.3d 1282.

4 Cases that cite this headnote

[11] Estoppel

Claim inconsistent with previous claim or position in general

As an equitable doctrine, judicial estoppel should apply only when the plaintiff's conduct is egregious enough that the situation

Slater v. United States Steel Corporation, 871 F.3d 1174 (2017)

2017 WL 4110047, 130 Fair Empl.Prac.Cas. (BNA) 727, 64 Bankr.Ct.Dec. 174...

demands equitable intervention; when a plaintiff intended no deception, judicial estoppel may not be applied.

2 Cases that cite this headnote

[12] Courts

Number of judges concurring in opinion, and opinion by divided court

An en banc court may overrule panel decisions.

Cases that cite this headnote

*1176 Appeal from the United States District Court for the Northern District of Alabama, D.C. Docket No. 2:09cv-01732-KOB

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Jon Erik Heath, Law Offices of Jon Erik Heath, SAN FRANCISCO, CA, NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS for Amicus Curiae.

Before ED CARNES, Chief Judge, TJOFLAT, MARCUS, WILSON, WILLIAM PRYOR, MARTIN, JORDAN, ROSENBAUM, JULIE CARNES, and JILL PRYOR, Circuit Judges.*

ON PETITION FOR REHEARING

JILL PRYOR, Circuit Judge:

**1 When an individual files for bankruptcy, he must file sworn disclosures listing his debts and his assets, including any pending civil claims, and identifying any lawsuits he has filed against others. Occasionally, a plaintiff who has a pending civil lawsuit fails to list the claims or lawsuit in these disclosures. In omitting this information, the plaintiff effectively takes inconsistent positions in the two judicial proceedings by asserting in the civil lawsuit that he has a claim against the defendant while denying under oath in the bankruptcy proceeding that the claim exists.

The equitable doctrine of judicial estoppel is intended to protect courts against parties who seek to manipulate the judicial process by changing their legal positions to suit the exigencies of the moment. Today, we address how this doctrine should be applied when a plaintiff takes inconsistent positions by pursuing in district court a civil claim that he failed to disclose as an asset in his bankruptcy proceedings. We reaffirm our precedent that when presented with this scenario, a district court may apply judicial estoppel to bar the plaintiff's civil claim if it finds that the plaintiff intended to make a mockery of the judicial system.

But what suffices for a district court to find that a plaintiff who did not disclose a civil lawsuit in bankruptcy filings intended to make a mockery of the judicial system? Our Court has endorsed a rule that the mere fact of the plaintiff's nondisclosure is sufficient, even if the plaintiff corrected his bankruptcy disclosures after the omission was called to his attention and the bankruptcy court allowed the correction without penalty. See Barger v. City of Cartersville, 348 F.3d 1289 (11th Cir. 2003); Burnes v. Pemco Aeroplex, Inc., 291 F.3d 1282 (11th Cir. 2002). We granted en banc review to reconsider this precedent.

We hold today that when determining whether a plaintiff who failed to disclose a civil lawsuit in bankruptcy filings intended to make a mockery of the judicial system, a district court should consider all the facts and circumstances of the case. The court should look to factors such as the *1177 plaintiff's level of sophistication, his explanation for the omission, whether he subsequently corrected the disclosures, and any action taken by the bankruptcy court concerning the nondisclosure. We acknowledge that in this scenario the plaintiff acted voluntarily, in the sense that he knew of his civil claim when completing the disclosure forms. But voluntariness alone does not necessarily establish a calculated attempt to

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undermine the judicial process. We therefore overrule the portions of *Burnes* and *Barger* that permit a district court to infer intent to misuse the courts without considering the individual plaintiff and the circumstances surrounding the nondisclosure.

Here, the district court applied judicial estoppel to bar plaintiff Sandra Slater's discrimination and retaliation claims in a lawsuit against her employer, U.S. Steel Corporation, because Slater failed to disclose these civil claims as assets in her bankruptcy. Relying on our precedent in *Burnes* and *Barger*, the district court inferred from Slater's nondisclosure alone that she intended to manipulate the judicial process. A panel of our Court affirmed, concluding that the district court did not abuse its discretion in applying judicial estoppel. Because we announce a new inquiry for evaluating intent to make a mockery of the judicial system, we remand to the panel so that it may decide whether the district court abused its discretion in light of this new standard.

I. Factual Background and Proceedings Below

**2 Slater, a high school graduate, worked for U.S. Steel for more than 10 years performing general manual labor. Slater sued U.S. Steel for discrimination based on race and sex in violation of Title VII, 42 U.S.C. § 2000e et seq, and 42 U.S.C. § 1981, and for retaliating against her after she complained of race and sex discrimination, in violation of Title VII and § 1981. U.S. Steel moved for summary judgment on all of Slater's claims. The district court granted the motion in part and denied it in part. The court denied summary judgment on Slater's claims that she suffered discrimination in job assignments based on her sex and was fired in retaliation for complaining about racial discrimination. Despite withstanding summary judgment, Slater never had an opportunity to present these claims to a jury.

About a month after the district court's summary judgment ruling, Slater—represented by different counsel than in her discrimination case—filed a petition for Chapter 7 bankruptcy. She did not disclose her lawsuit against U.S. Steel in her bankruptcy petition or the schedules filed with her petition. When asked under penalty of perjury in Schedule B-Personal Property to identify any "contingent and unliquidated claims," she answered "none." Voluntary Pet. at 10, *In re Slater*,

No. 11-02865 (Bankr. N.D. Ala. June 2, 2011), ECF No. 1. And when asked under penalty of perjury in her Statement of Financial Affairs to identify any "suits and administrative proceedings to which the debtor is or was a party within one year immediately preceding the filing of this bankruptcy case," she again answered "none." *Id.* at 29 (emphasis omitted).

After Slater filed her disclosures, the bankruptcy trustee issued a Report of No Distribution, finding there was no property available for distribution from the estate over and above that exempted by law. In the absence of any objections to the report, 30 days later the estate became presumptively fully administered. *See* Fed. R. Bankr. P. 5009(a).

The next day, U.S. Steel again moved for summary judgment in the employment discrimination case, this time on the ground that because Slater failed to disclose her civil claims in the bankruptcy *1178 proceeding, the doctrine of judicial estoppel should bar her from pursuing those claims. In response, Slater testified by declaration that she did not intentionally misrepresent facts to the bankruptcy court. She further explained that she misunderstood the question in the Statement of Financial Affairs regarding "suits and administrative proceedings to which the debtor is or was a party" as asking only about suits filed against her.

The next business day after U.S. Steel filed the motion, Slater amended her Statement of Financial Affairs and Schedule B to her bankruptcy petition to disclose her claims against U.S. Steel. The bankruptcy trustee then filed with the bankruptcy court a request to employ the lawyers who were representing Slater in her employment action to continue to pursue the claims against U.S. Steel on behalf of the estate. The bankruptcy court granted the motion.

The bankruptcy case proceeded: upon Slater's petition, the court converted the case from a Chapter 7 to a Chapter 13 proceeding, and Slater filed a proposed Chapter 13 plan, which the bankruptcy court confirmed. Later, though, when Slater failed to pay the trustee under the terms of the confirmed plan, the bankruptcy court dismissed her case, meaning her debts never were discharged in bankruptcy.

Slater's civil action fared no better. The district court granted U.S. Steel's motion for summary judgment,

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applying the doctrine of judicial estoppel to bar her claims. The court rejected Slater's arguments that her omission of the civil claims in the bankruptcy proceeding was inadvertent and that she never intended to thwart the judicial process. The court explained that under our circuit precedent, a failure to disclose is "'inadvertent' only when ... the debtor either lacks knowledge of the undisclosed claims or has no motive for their concealment." Order at 11 (emphasis added) (Doc. 89) ¹ (quoting *Barger*, 348 F.3d at 1295-96).

**3 The district court found that Slater knew about her civil claims, filed in 2009, when she completed the bankruptcy disclosures in 2011 and that she had a motive to conceal the claims "to defraud creditors into accepting her [bankruptcy] case as one involving no assets for distribution despite the real possibility with the impending trial of the discrimination case that she could soon be receiving a money settlement or a money judgment in her favor." Id. at 12. Although Slater corrected her disclosures immediately after U.S. Steel brought the omissions to light, the district court found this fact irrelevant because "waiting until after being caught to rectify the omission is too little, too late." *Id.* Following *Burnes*, *Barger*, and their progeny, the court drew an inference that Slater intended to make a mockery of the judicial system based on its finding that she had knowledge of the undisclosed claims and a motive to conceal them.

Slater appealed. After oral argument, a panel of this Court affirmed the district court's grant of summary judgment to U.S. Steel. In a concurring opinion, Judge Tjoflat urged the Court to review en banc our precedent permitting the inference on which the district court relied, that a plaintiff who omitted a civil claim as an asset in bankruptcy filings necessarily intended to make a mockery of the judicial system. See Slater v. U.S. Steel Corp., 820 F.3d 1193, 1235 (11th Cir.) (Tjoflat, J., concurring) (explaining that our precedent validating such an inference "guarantees the very mockery of justice the doctrine of judicial estoppel was designed to avoid"), reh'g en banc granted, op. vacated, *1179 820 F.3d 1193 (11th Cir. 2016). We agreed to rehear the case en banc and vacated the panel opinion.

II. Overview of Bankruptcy Principles

Before turning to judicial estoppel, we pause for an overview of the Chapter 7 and Chapter 13 bankruptcy

procedures that allow debtors to discharge their financial obligations and receive a fresh start to explain how a debtor's pending civil claim is treated in bankruptcy. See Grogan v. Garner, 498 U.S. 279, 286-87, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991) (explaining that bankruptcy is designed to give "honest but unfortunate debtor[s]" the opportunity to "reorder their affairs, make peace with their creditors, and enjoy a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt" (internal quotation marks omitted)). For our purposes here, the main difference between a Chapter 7 and a Chapter 13 proceeding is that creditors are paid primarily with the debtor's prepetition assets in Chapter 7 and with his postpetition earnings in Chapter 13.

[1] "Chapter 7 allows a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets." Harris v. Viegelahn, – U.S. —, 135 S.Ct. 1829, 1835, 191 L.Ed.2d 783 (2015). When a debtor files a Chapter 7 petition, his assets, subject to certain exemptions, are immediately transferred to a bankruptcy estate. 11 U.S.C. § 541(a)(1). The Chapter 7 trustee is responsible for selling the property in the estate and distributing the proceeds to creditors. 2 Id. §§ 704(a)(1), 726. Although a Chapter 7 debtor "must forfeit virtually all his prepetition property," the bankruptcy laws give the debtor an immediate fresh start and a break from the financial past "by shielding from creditors his postpetition earnings and acquisitions." Harris, 135 S.Ct. at 1835. The debtor may keep any wages earned or assets acquired after the bankruptcy filing. Id. (citing 11 U.S.C. § 541(a)(1)).

[2] In contrast, a debtor who proceeds under Chapter 13 may keep his prepetition property but must repay his creditors over time, generally from what he earns after filing bankruptcy. The Chapter 13 debtor proposes a plan to repay his debts over a three- or five-year period; the plan must be confirmed by the bankruptcy court. Payments under the plan "are usually made from a debtor's 'future earnings or other future income.' " *Id.* (quoting 11 U.S.C. 1322(a)(1)). In determining the sufficiency of the proposed plan payments, the bankruptcy court must consider the value of the debtor's assets because the court may confirm the plan only if the present value of the proposed repayments is "not less than the amount that would be paid" to creditors if the debtor's assets were liquidated under Chapter 7. *See* 11 U.S.C. § 1325(a)(4).

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If the bankruptcy court confirms the plan, the trustee generally collects a portion of the debtor's wages through payroll deduction and then distributes the withheld wages to the creditors at the plan's conclusion. *See Harris*, 135 S.Ct. at 1835. If the debtor completes his payments under the plan, his debts are discharged. ³ *See id.*

**4 When a debtor files for bankruptcy under Chapter 13, his assets are transferred to the bankruptcy estate. See *1180 11 U.S.C. § 1306(a). But after the bankruptcy plan is confirmed, the property of the estate returns to the debtor except as provided in the plan or order confirming the plan. See id. § 1327(b). A Chapter 13 debtor generally is permitted to retain his assets, such as his home or car. See Harris, 135 S.Ct. at 1835.

[3] Given these differences, when a debtor's assets include a civil claim, the claim will be treated differently depending upon whether the bankruptcy is a Chapter 7 or a Chapter 13 proceeding. Because a Chapter 7 debtor forfeits his prepetition assets to the estate, only the Chapter 7 trustee, not the debtor, has standing to pursue a civil legal claim unless the trustee abandons the asset, which then returns the claim to the possession and control of the debtor. See Parker v. Wendy's Int'l, Inc., 365 F.3d 1268, 1272 (11th Cir. 2004). But a Chapter 13 debtor retains standing to continue to pursue the civil claim. See 11 U.S.C. § 1303; Fed. R. Bankr. P. 6009 ("With or without court approval, the ... debtor in possession may prosecute ... any pending action or proceeding by ... the debtor, or commence and prosecute any action or proceeding in behalf of the estate before any tribunal."). Thus, a Chapter 13 debtor may continue to control the lawsuit and the terms of any settlement. See Crosby v. Monroe Cty., 394 F.3d 1328, 1331 n.2 (11th Cir. 2004). With these bankruptcy principles and distinctions in mind, we now turn to the doctrine of judicial estoppel.

III. Judicial Estoppel Analysis

[4] [5] The precise issue before us is how the doctrine of judicial estoppel should be applied when a plaintiff fails to identify a pending civil claim as an asset in a bankruptcy proceeding. To address this issue, we begin by reaffirming that a district court may apply judicial estoppel when a two-part test is satisfied: the plaintiff (1) took a position under oath in the bankruptcy proceeding that was inconsistent with the plaintiff's pursuit of the civil

lawsuit and (2) intended to make a mockery of the judicial system. ⁴

We then discuss how a district court should apply the second prong. Our precedent has, in effect, treated the fact of the plaintiff's omission as establishing the requisite intent. Today we clarify that the district court must consider all the facts and circumstances in determining whether the plaintiff acted with the intent to make a mockery of the judicial system.

A. To Invoke Judicial Estoppel in the Bankruptcy Scenario, District Courts Should Continue to Apply Our Two-Part Test.

[6] The equitable doctrine of judicial estoppel is intended to "prevent the perversion of the judicial process" and "protect [its] integrity ... by prohibiting parties from deliberately changing positions according to the exigencies of the moment." New Hampshire, 532 U.S. at 749-50, 121 S.Ct. 1808 (citations and internal quotation marks omitted); see also 18 James Wm. Moore et al., Moore's Federal Practice ¶ 131.13[6] (3d ed. 2015) (explaining that doctrine of judicial estoppel is concerned with "the orderly administration of justice and regard for the dignity of court proceedings"). When a party does so, the doctrine of judicial estoppel allows a court to exercise its discretion to dismiss the party's claims. See New Hampshire, 532 U.S. at 750, 121 S.Ct. 1808. Stated simply, the doctrine of judicial estoppel *1181 rests on the principle that "absent any good explanation, a party should not be allowed to gain an advantage by litigation on one theory, and then seek an inconsistent advantage by pursuing an incompatible theory." Ryan Operations G.P. v. Santiam-Midwest Lumber Co., 81 F.3d 355, 358 (3d Cir. 1996) (quoting 18 Charles A. Wright, Arthur R. Miller & Edward H. Cooper, Federal Practice and Procedure § 4477 (1981)).

**5 [7] [8] [9] Our circuit employs a two-part test to guide district courts in applying judicial estoppel: whether (1) the party took an inconsistent position under oath in a separate proceeding, and (2) these inconsistent positions were "calculated to make a mockery of the judicial system." *Burnes*, 291 F.3d at 1285 (internal quotation marks omitted). Under this test, a district court considers both the plaintiff's actions—whether he made inconsistent statements—and his motive—whether he intended to make a mockery of the judicial system. Judicial estoppel

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should not be applied when the inconsistent positions were the result of "inadvertence[] or mistake" because judicial estoppel "looks towards cold manipulation and not an unthinking or confused blunder." *Johnson Serv. Co. v. Transamerica Ins. Co.*, 485 F.2d 164, 175 (5th Cir. 1973). ⁵

Before we formulated our two-part test in Burnes, the United States Supreme Court addressed the doctrine of judicial estoppel in New Hampshire v. Maine, which concerned a boundary dispute between the two states. Availing itself of the Supreme Court's original jurisdiction, New Hampshire sought a declaration that the low water mark of a river on Maine's shore was the boundary between the two states. 532 U.S. at 745, 747, 121 S.Ct. 1808. Maine moved to dismiss the case, arguing that judicial estoppel should bar New Hampshire's action because in previous litigation between the two states New Hampshire had agreed to a consent decree that set the boundary at the middle of the river's main channel of navigation. Id. at 748, 121 S.Ct. 1808. The Supreme Court applied judicial estoppel to bar New Hampshire's later attempt to claim more land by arguing for a different boundary. Id. at 749, 121 S.Ct. 1808.

The Court announced a three-part test that "typically inform[s]" the decision whether to apply the judicial estoppel doctrine: (1) "a party's later position must be clearly inconsistent with its earlier position"; (2) the party had to "succeed[] in persuading a court to accept that party's earlier position, so that judicial acceptance of" the party's later position "would create the perception that either the first or the second court was misled"; and (3) the party "seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped." *Id.* at 750-51, 121 S.Ct. 1808 (internal quotation marks omitted). Additionally, the Court recognized that judicial estoppel should not be applied "when a party's prior position was based on inadvertence or mistake." Id. at 753, 121 S.Ct. 1808 (internal quotation marks omitted). Although the Court announced this three-part test, it emphasized that it was "not establish [ing] inflexible prerequisites or an exhaustive formula for determining the applicability of judicial estoppel." *Id.* at 751, 121 S.Ct. 1808. 6

*1182 Slater argues that we must abandon our test for applying judicial estoppel in favor of the *New Hampshire* test. In *New Hampshire*, though, the party seeking to apply judicial estoppel, Maine, was a party to the prior lawsuit in

which New Hampshire had taken an inconsistent position. See id. at 745, 121 S.Ct. 1808. The Supreme Court was not presented with—and so did not address—the question of how judicial estoppel should be applied when the party seeking to invoke the doctrine was not a party to the other proceeding. Here, because the party seeking to invoke judicial estoppel, U.S. Steel, was not a party to the bankruptcy case and could not have been unfairly disadvantaged by any position Slater took in that case, we conclude that New Hampshire is inapplicable. Consistent with New Hampshire's recognition that its test was not exhaustive, we adhere to our two-part test in the scenario before us. ⁷

B. Under Our Precedent, a Plaintiff Who Omitted a Civil Claim in a Bankruptcy Filing Is Deemed to Have Intended to Make a Mockery of the Judicial System.

**6 Turning back to our two-part test for applying judicial estoppel, the first part is satisfied because Slater took an inconsistent position under oath in her bankruptcy proceeding. We focus today on the second part: how a court should determine whether a plaintiff intended make a mockery of the judicial system.

In *Burnes* and *Barger*, we endorsed an inference that a plaintiff who failed to disclose a lawsuit in a Chapter 7 bankruptcy intended to manipulate the judicial system because the omission was not inadvertent. In effect, we treated the fact that the plaintiff could potentially benefit from the nondisclosure as sufficient to establish that the plaintiff, in fact, intended to deceive the court and manipulate the proceedings. And we subsequently extended that reasoning to cases involving Chapter 13 debtors as well. ⁸

1. Burnes v. Pemco Aeroplex, Inc.

In *Burnes*, we held that a district court did not abuse its discretion in applying judicial estoppel to bar plaintiff Levi Billups's claims in a civil lawsuit when he failed to disclose those claims as assets in his bankruptcy filings. *See* 291 F.3d at 1286-88. After Billups filed for Chapter 13 bankruptcy, he sued his employer, Pemco, for racial discrimination, but never amended his bankruptcy disclosures to identify the lawsuit. When Billups later sought to convert the Chapter 13 petition into a Chapter 7, the bankruptcy court ordered him to update his schedules

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to reflect changes since the original filing. He nevertheless *1183 failed to report his pending lawsuit and then received a no-asset discharge of his debts under Chapter 7. After the bankruptcy was closed, Pemco moved for summary judgment based on judicial estoppel. *Id.* The district court granted the motion, and we affirmed. *Id.* at 1284, 1289.

In reviewing the district court's application of judicial estoppel, we applied our two-part test inquiring whether the debtor took an inconsistent position under oath in another proceeding and whether the inconsistency was calculated to make a mockery of the judicial system. *Id.* at 1285. Because it was beyond dispute that Billups had taken inconsistent positions about the existence of his civil claims, we characterized the issue on appeal as "one of intent." *Id.* at 1286.

Billups argued that he lacked the requisite intent to mislead the court. Looking to decisions of other circuits, we concluded that the district court permissibly drew an inference that Billups had engaged in intentional manipulation. See id. at 1287. Obviously Billups knew about his civil claims, which he was pursuing in a separate action. And an incentive existed to hide the lawsuit from his creditors because it was "unlikely he would have received the benefit of ... a no asset, complete discharge had his creditors, the trustee, or the bankruptcy court known of a lawsuit claiming millions of dollars in damages." Id. at 1288. We permitted the inferential leap from Billups's potential motive to hide the lawsuit to the conclusion that he in fact acted with such a motive and thus intended to manipulate the proceedings.

Billups also argued that the doctrine of judicial estoppel should not be applied because he could reopen his bankruptcy case and amend his filings to disclose the lawsuit. We rejected this argument, explaining that a debtor should not be permitted to escape judicial estoppel simply by correcting his nondisclosure once it has been discovered. Because "[t]he success of our bankruptcy laws requires a debtor's full and honest disclosure," we reasoned, a debtor cannot "back-up, re-open the bankruptcy case, and amend his bankruptcy filings" after his adversary raises judicial estoppel. *Id.* Allowing the debtor to proceed in these circumstances, we said, would "suggest[] that a debtor should consider disclosing potential assets only if he is caught concealing them," which "would only diminish the necessary incentive to

provide the bankruptcy court with a truthful disclosure" of assets. *Id.*

2. Barger v. City of Cartersville

**7 In *Barger*, a 2-1 decision, the panel majority followed Burnes in holding that a district court did not abuse its discretion when it found, based solely on the debtor's failure to disclose her civil claims in her bankruptcy proceedings, that she intended to make a mockery of the judicial system. See Barger, 348 F.3d at 1297. After Barger was demoted, she brought employment discrimination claims against her employer, the City of Cartersville, seeking money damages and reinstatement to her earlier position. While her lawsuit was pending, Barger filed for Chapter 7 bankruptcy but omitted her civil claims from her disclosures. Id. at 1291. Barger had told both her bankruptcy attorney and the trustee that she had a pending lawsuit against the City, in which she sought reinstatement to her former position, but she had failed to mention that she also sought damages. Id. After Barger received a no-asset discharge of her debts, the City moved for summary judgment based on judicial estoppel. Barger then asked the bankruptcy court to reopen her case so that she could disclose her employment discrimination claims. Id. at 1291-92. After a hearing in which the City participated, the bankruptcy court permitted Barger to reopen and allowed the trustee to pursue the claims against *1184 the City, finding that Barger had neither intentionally concealed the discrimination claims nor sought to obtain an advantage for herself by failing to disclose them. *Id.* Nonetheless, the district court applied judicial estoppel to bar the claims. *Id.* at 1292.

The panel majority affirmed the district court's application of judicial estoppel and, following *Burnes*, conflated the inquiry into whether Barger had acted voluntarily with the inquiry into whether she intended to make a mockery of the judicial system. *See id.* at 1294. To determine whether Barger had the requisite intent, the panel majority considered whether her nondisclosure was "inadvertent" by looking to whether she knew about the undisclosed claims and had a motive to conceal them. *Id.* at 1295-96. As to motive, the panel majority recognized that a debtor who omitted such a claim would be able to "keep any proceeds for herself and not have them become part of the bankruptcy estate." *Id.* at 1296.

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The dissent in *Barger* objected to the panel majority's analysis of Barger's intent to make a mockery of the judicial system. *Id.* at 1298 (Barkett, J., dissenting). The dissent argued that the majority had improperly treated the fact that Barger's omission was not "inadvertent" as sufficient to establish that she had intended to mislead the court. *See id.* (explaining that the "failure to meet the specific inadvertence criteria" does not "automatically impl[y] an intent to make a mockery of the judicial system" (internal quotation marks omitted)). The dissent urged that courts should look to "all of the circumstances of [the] particular case" to determine whether the debtor had the requisite intent. *Id.* at 1297-98 (internal quotation marks omitted).

3. Cases Post *Burnes* and *Barger*

Even though *Burnes* and *Barger* both involved Chapter 7 bankruptcies, we have extended their reasoning to cases involving Chapter 13 debtors. *See De Leon v. Comcar Indus., Inc.*, 321 F.3d 1289, 1292 (11th Cir. 2003) (holding that because Chapter 13 debtor "knew about his [civil] claim and possessed a motive to conceal it[,] ... we can infer from the record his intent to make a mockery of the judicial system" (internal quotation marks omitted)). We acknowledged that a Chapter 13 debtor would always have a potential motive to conceal a civil claim from creditors so as to "keep the proceeds for herself and den[y] the creditors a fair opportunity to claim what was rightfully theirs." *See Robinson v. Tyson Foods, Inc.*, 595 F.3d 1269, 1275-76 (11th Cir. 2010).

It is true that in two panel decisions after *Burnes* and Barger we applied judicial estoppel more narrowly, but these decisions cannot be reconciled with our prior precedent. First, in *Parker*, we reversed the district court's application of judicial estoppel to bar an employment discrimination claim that a debtor failed to disclose as an asset in his Chapter 7 bankruptcy petition. 365 F.3d at 1269. We said that judicial estoppel should not be applied in that case because when the debtor filed Chapter 7 bankruptcy, the trustee, as representative of the bankruptcy estate, became "the proper party in interest, and ... the only party with standing to prosecute causes of action belonging to the estate." Id. at 1272. We held that because the trustee was the real party in interest in the civil lawsuit, had never taken an inconsistent position under oath, and had not abandoned the discrimination

claim, the district court abused its discretion in applying judicial estoppel. *Id.* As the panel in the case before us recognized, *Parker* cannot be reconciled with our decision in *Barger*, in which we upheld the application *1185 of judicial estoppel to bar civil claims that the Chapter 7 debtor failed to disclose, even though we acknowledged that the trustee was the real party in interest.

**8 Second, in Ajaka v. Brooksamerica Mortgage Corp., 453 F.3d 1339 (11th Cir. 2006), we looked beyond a Chapter 13 debtor's failure to disclose a civil lawsuit to determine whether the debtor actually intended to make a mockery of judicial proceedings. After filing a Chapter 13 petition, Ajaka filed a Truth in Lending Act claim against his mortgage lender. Id. at 1342. Ajaka directed his bankruptcy attorney to amend his bankruptcy schedules to disclose the lawsuit, but his attorney failed to do. *Id.* at 1343. Because Ajaka had failed to disclose his claim to the bankruptcy court, the lender moved for summary judgment based on judicial estoppel. Even though the record showed that all the creditors were aware of Ajaka's civil claims against the lender before the lender raised judicial estoppel, the district court found that Ajaka intended to make a mockery of the judicial system. *Id.* We reversed and held that the district court abused its discretion in applying judicial estoppel when there was a question of material fact about whether Ajaka had an intention to conceal his civil claim from his creditors. We relied in part on the fact that he had subsequently amended his bankruptcy schedules. *Id.* at 1346.

Ajaka cannot be squared with *Burnes* and *Barger*, which looked solely to whether the debtor omitted a claim to determine the debtor's intent. Given the flaws in our reasoning in *Burnes* and *Barger* and the inconsistencies in our precedent, we now address how district courts should evaluate a debtor's intent.

C. Deciding Whether a Plaintiff Intended to Make a Mockery of the Judicial System Requires Review of the Totality of the Facts and Circumstances.

[10] We hold that to determine whether a plaintiff's inconsistent statements were calculated to make a mockery of the judicial system, a court should look to all the facts and circumstances of the particular case. When the plaintiff's inconsistent statement comes in the form of an omission in bankruptcy disclosures, the court may consider such factors as the plaintiff's level of sophistication, whether and under what circumstances the

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plaintiff corrected the disclosures, whether the plaintiff told his bankruptcy attorney about the civil claims before filing the bankruptcy disclosures, whether the trustee or creditors were aware of the civil lawsuit or claims before the plaintiff amended the disclosures, whether the plaintiff identified other lawsuits to which he was party, and any findings or actions by the bankruptcy court after the omission was discovered. ⁹ We overrule the portions of *Burnes* and *Barger* that permitted the inference that a plaintiff intended to make a mockery of the judicial system simply because he failed to disclose a civil claim. ¹⁰

Three reasons lead us to reject the inference we accepted in Burnes and Barger in favor of a rule that a district court should look to all the circumstances of the case. First, such an inquiry ensures that judicial estoppel is applied only when a party acted with a sufficiently culpable *1186 mental state. Second, it allows a district court to consider any proceedings that occurred in the bankruptcy court after the omission was discovered, arguably a better way to ensure that the integrity of the bankruptcy court is protected. Third, limiting judicial estoppel to those cases in which the facts and circumstances warrant it is more consistent with the equitable principles that undergird the doctrine. By rejecting a one-size-fits-all approach, we reduce the risk that the application of judicial estoppel will give the civil defendant a windfall at the expense of innocent creditors.

**9 First, a district court should look to all the facts and circumstances of the case to decide whether a plaintiff intended to mislead the court because that question is separate from and not answered by whether the plaintiff voluntarily, as opposed to inadvertently, omitted assets. Our decisions in *Burnes* and *Barger* conflated the question of whether the plaintiff's omission was inadvertent with the separate question of whether the plaintiff actually intended to manipulate the judicial system to his advantage.

After all, a plaintiff may have failed to disclose a pending lawsuit because he did not understand the disclosure obligations. It is not difficult to imagine that some debtors, particularly those proceeding *pro se*, ¹¹ may not realize that a pending lawsuit qualifies as a "contingent and unliquidated claim" that must be disclosed on a schedule of assets. Although the question asking for a list of "all suits and administrative proceedings to which the

debtor is or was a party" seems more straightforward, as Slater's testimony shows, it nevertheless may be misunderstood. ¹² So it makes sense that a district court should look beyond a plaintiff's omission in determining whether the plaintiff intended to misuse the judicial process.

Second, a broader inquiry allows a district court to consider any findings or other actions by the bankruptcy court that might help in determining whether the debtor purposely intended to mislead the court and creditors. We have justified applying judicial estoppel after a debtor omitted a claim from his bankruptcy disclosures as necessary to ensure full and honest disclosure to the bankruptcy courts and protect "the effective functioning of the federal bankruptcy system." *Burnes*, 291 F.3d at 1286 (internal quotation marks omitted). But we have overlooked that bankruptcy courts do not necessarily view such omissions as establishing a debtor's intent to mislead the bankruptcy court.

To the contrary, the Bankruptcy Code and Rules liberally permit debtors to amend their disclosures when an omission is discovered. Yes, the Bankruptcy Code requires debtors to disclose all their assets, including contingent and unliquidated claims. See 11 U.S.C. § 521(a)(1)(B) (requiring debtor to file a schedule of assets and liabilities). But Bankruptcy Rule 1009, which was proposed by the Supreme Court and adopted by Congress, permits a debtor to amend a schedule or statement "as a matter of course at any time before the case is closed." Fed. R. Bankr. R. P. 1009(a). Further, the bankruptcy court retains broad discretion to reopen a closed case on a motion of the debtor or another party in interest "to administer" an asset that had not previously been *1187 scheduled. 11 U.S.C. § 350(b). It strikes us as inconsistent with these principles—which recognize that omissions occur and liberally allow amendment and correction of disclosures—to infer that a debtor who failed to disclose a lawsuit necessarily meant to manipulate the bankruptcy proceedings.

We see no good reason why, when determining whether a debtor intended to manipulate the judicial system, a district court should not consider the bankruptcy court's treatment of the nondisclosure. We reject the idea that encouraging a district court to blind itself to subsequent proceedings in the bankruptcy court, particularly the bankruptcy court's decision about whether to allow the

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debtor to amend his disclosures or reopen his bankruptcy case, better protects the bankruptcy system. Indeed, the bankruptcy court has tools of its own to punish a debtor who it determines purposefully tried to hide assets. For example, it may revoke the discharge or deny an exemption for the proceeds from the debtor's lawsuit, *see In re Barger*, 279 B.R. 900, 908 (Bankr. N.D. Ga. 2002); it may even fine or imprison a debtor for contempt or refer the matter for the United States Attorney's Office to consider prosecuting the debtor for perjury. *See* 18 U.S.C. §§ 401, 1621. ¹³

**10 Third, considering all the circumstances of the case is more consistent with the equitable principles that underlie the doctrine of judicial estoppel. "Equity eschews mechanical rules" and "depends on flexibility." *Holmberg v. Armbrecht*, 327 U.S. 392, 396, 66 S.Ct. 582, 90 L.Ed. 743 (1946). ¹⁴ Requiring the district court to consider all facts and circumstances in evaluating the plaintiff's intent is the more flexible, less mechanical approach that equity demands. In addition, this approach reduces the likelihood that an otherwise liable civil defendant will receive an unjustified windfall or that innocent creditors will be harmed.

[11] When a district court applies a judicial estoppel bar based on nondisclosure in a bankruptcy proceeding without determining that the plaintiff deliberately intended to mislead, the civil defendant avoids liability on an otherwise potentially meritorious civil claim while providing no corresponding benefit to the court system. As an equitable doctrine, judicial estoppel should apply only when the plaintiff's conduct is egregious enough that the situation "demand[s] equitable intervention." Hazel-Atlas Glass Co. v. Hartford-Empire Co., 322 U.S. 238, 248, 64 S.Ct. 997, 88 L.Ed. 1250 (1944). When a plaintiff intended no deception, judicial estoppel may not be applied. If a court applies judicial estoppel to bar the plaintiff's claim absent such intent, it awards the civil defendant an unjustified windfall. 15 Just as equity *1188 frowns upon a plaintiff's pursuit of a claim that he intentionally concealed in bankruptcy proceedings, equity cannot condone a defendant's avoidance of liability through a doctrine premised upon intentional misconduct without establishing such misconduct. See Coral Springs St. Sys, Inc. v. City of Sunrise, 371 F.3d 1320, 1340-41 (11th Cir. 2004) (explaining that a court of equity must "promote and enforce justice, good faith, uprightness,

fairness, and conscientiousness" from both plaintiff and defendant (internal quotation marks omitted)).

What is more in this circumstance, the application of judicial estoppel poses a potential risk of harm to innocent creditors. When a civil claim is dismissed on the basis of judicial estoppel, the asset becomes worthless—losing any potential to increase the value of the bankruptcy estate —which in turn harms creditors. It is easy to see why in Chapter 7 proceedings: the trustee is responsible for liquidating the assets in the estate and then distributing the proceeds to creditors. When the civil claim is dismissed, there can be no proceeds from a recovery or settlement for distribution to creditors. *See* 11 U.S.C. §§ 704(a)(1), 726. ¹⁶

**11 Although not as apparent for Chapter 13 proceedings, a risk remains that the dismissal will harm creditors. The amount of proceeds that creditors receive in a Chapter 13 bankruptcy is dictated by the confirmed plan, and a debtor's payments under the plan are generally based upon the debtor's expected future earnings. See Harris, 135 S.Ct. at 1835. But a plan can be confirmed only if the payments to the creditors are either equal to or exceed what the creditors would have received in a Chapter 7 bankruptcy, meaning that the value of a civil claim is taken into account in formulating and reviewing the plan. See 11 U.S.C. § 1325(a)(4). If the debtor, trustee, creditors, and bankruptcy court know that a civil claim is likely to be dismissed based on judicial estoppel, they are likely to treat the claim as worthless, depriving the bankruptcy estate of what (absent judicial estoppel) might have been a valuable asset. Because the application of judicial estoppel may harm innocent creditors, equitable principles dictate that courts proceed with care and consider all the relevant circumstances.

In the face of these compelling reasons why district courts should consider the totality of the facts and circumstances of the case to determine whether a plaintiff intended to make a mockery of the judicial system, U.S. Steel urges us to adhere to *Burnes* and *Barger*. First, U.S. Steel argues *1189 that no change to our precedent is required because even when a district court finds that the plaintiff intended to manipulate the judicial system, the court remains "entirely free to find in particular circumstances that a debtor's omission was inadvertent." Appellee's Br. at 3. But U.S. Steel overlooks that under our case law an omission of a claim is "inadvertent' *only* when a [debtor]

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either lacks knowledge of the undisclosed claim or has no motive for [its] concealment." *Barger*, 348 F.3d at 1295 (emphasis added). No plaintiff who omitted civil claims from bankruptcy disclosures will be able to show that he acted inadvertently because, as we explained above, the plaintiff always will have knowledge of his pending civil claim and a potential motive to conceal it due to the very nature of bankruptcy. The Supreme Court has told us that judicial estoppel must not be applied to an inadvertent inconsistency, *New Hampshire*, 532 U.S. at 753, 121 S.Ct. 1808, yet under our precedent inadvertence places no meaningful limit on the doctrine's application.

[12] Second, U.S. Steel argues that by overruling *Burnes* and *Barger*, we will create a circuit split. In fact, a circuit split exists regardless. The approach we adopt today is consistent with the decisions of at least three other circuits, which have recognized that whether a plaintiff intended to make a mockery of the judicial system requires consideration of more than just whether the plaintiff failed to disclose a claim. ¹⁷ Other circuits, consistent with *Burnes* and *Barger*, have endorsed the inference that a plaintiff who omitted a claim necessarily intended to manipulate the judicial system. ¹⁸ For the reasons we have already discussed, we find the analysis of the Sixth, Seventh, and Ninth Circuits to be more persuasive and conclude that theirs is the better approach. ¹⁹

**12 We thus overrule our prior precedent approving the inference that a plaintiff intended to make a mockery of the judicial system solely because he failed to disclose his civil claim in his bankruptcy. Instead, district courts should consider all the facts and circumstances of the case to determine whether the debtor had the requisite intent.

IV. Conclusion

Having identified the proper standard for determining when judicial estoppel may be applied, we remand this appeal to the panel to consider whether the district court abused its discretion in applying judicial estoppel and to resolve any other remaining issues.

REMANDED.

*1190 ED CARNES, Chief Judge, concurring:

I concur in the majority opinion for the Court, especially in light of footnote 12, which acknowledges that a district court is not required to accept the testimony of the plaintiff that her misstatements in the bankruptcy proceeding were not made with intent to mislead, even if that testimony is uncontradicted.

This is in keeping with the long-established law of this circuit. See, e.g., Burston v. Caldwell, 506 F.2d 24, 26 (5th Cir. 1975) ("The district court, of course, was not required to accept [the petitioner's] testimony, even if uncontradicted."); Negron v. City of Miami Beach, 113 F.3d 1563, 1570 (11th Cir. 1997) (noting that the district court as factfinder was free to reject an expert witness' testimony even if it was uncontradicted); Murphy v. City of Flagler Beach, 846 F.2d 1306, 1310 (11th Cir. 1988) (explaining that the factfinder "was not bound to accept the plaintiff's evidence ... even if it was not controverted"); see also United States v. Samples, 897 F.2d 193, 198 (5th Cir. 1990) ("The trier of fact need not credit any witness' testimony, even if unimpeached.").

We have taken the principle even further than that. In criminal cases, "[w]e have long recognized that a statement by a defendant, if disbelieved by the jury, may be considered substantive evidence of the defendant's guilt." United States v. Tobin, 676 F.3d 1264, 1287 (11th Cir. 2012) (quotation marks omitted), abrogated on other grounds by United States v. Davila, 569 U.S. —, 133 S.Ct. 2139, 186 L.Ed.2d 139 (2013); United States v. Martinez, 83 F.3d 371, 374 (11th Cir. 1996) ("But the jury was entitled to reject Martinez's testimony and to consider it as substantive evidence of his guilt."). And "this rule applies with special force," we have stressed, "where the element to be proved is the defendant's knowledge or intent." Martinez, 83 F.3d at 374-75; accord United States v. Vazquez, 53 F.3d 1216, 1225 (11th Cir. 1995) (noting that the rule a factfinder, after observing a defendant testify, can infer that the opposite of her testimony is true "applies with special force where the elements to be proved for a conviction include highly subjective elements: for example, the defendant's intent or knowledge").

All of those decisions are particularly important in light of our holding today that judicial estoppel will bar a claim not disclosed by the plaintiff in her bankruptcy proceeding only if the omission was done with the intent to mislead. The intent behind an inaccurate or misleading statement or omission is a purely subjective fact that can

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seldom be proven by objective facts alone. People who have defrauded others through misleading bankruptcy schedules, which are signed under penalty of perjury, have committed a crime. It is a small step from original perjury to cover-up perjury.

**13 If district courts were required to accept a plaintiff's testimony that she did not intend to defraud her creditors by omitting a claim from her bankruptcy schedules, judicial estoppel never would be applied in these circumstances. The possibility that the doctrine could apply to claims not disclosed in bankruptcy proceedings would be purely academic and serve no deterrent purpose. And if debtors were freed from any threat of judicial estoppel, the losers would be both honest creditors and the integrity of the judicial process, which means we all would lose.

That is why the one sentence contained in footnote 12 is so important. It means that in deciding whether a plaintiff intended to mislead when she omitted a claim from her bankruptcy schedules, or failed to update a schedule to include the claim, the district court is not required to accept the plaintiff's denial of her intent. And that is true even if her denial is made under oath and not contradicted by other evidence. *1191 The district court has the authority and responsibility to find the facts and not to blindly accept testimony.

All Citations

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Footnotes

- Judge Hull recused herself and did not participate in these en banc proceedings. Judge Newsom joined the Court on August 4, 2017, and did not participate in these en banc proceedings.
- 1 Citations to "Doc." refer to numbered docket entries in the district court record.
- When all the debtor's assets are exempt from the bankruptcy estate, meaning that no property is available for distribution to creditors, streamlined procedures may apply. See Fed. R. Bankr. P. 2002(e).
- If the debtor fails to make payments due under a Chapter 13 plan, he may be forced to convert to a Chapter 7 proceeding or the court may dismiss his bankruptcy case entirely. See 11 U.S.C. § 1307(a)-(c).
- Because judicial estoppel is an equitable doctrine, we review the district court's decision to apply the doctrine for abuse of discretion. See New Hampshire v. Maine, 532 U.S. 742, 750, 121 S.Ct. 1808, 149 L.Ed.2d 968 (2001); Talavera v. Sch. Bd. of Palm Beach Cty., 129 F.3d 1214, 1216 (11th Cir. 1997).
- Decisions of the former Fifth Circuit handed down before the close of business on September 30, 1981 are binding on this Court. See Bonner v. City of Prichard, 661 F.2d 1206, 1209 (11th Cir. 1981) (en banc).
- The Supreme Court concluded that all three parts of the test were satisfied: New Hampshire had taken inconsistent positions by changing its argument about the location of the boundary, it had succeeded in persuading the Supreme Court to accept its earlier position when the Court accepted the parties' agreement about the location of the boundary and entered a consent decree, and it would gain an unfair advantage at Maine's expense if permitted to seek to move the boundary. See New Hampshire, 532 U.S. at 751-55, 121 S.Ct. 1808. And "New Hampshire's position" could not "be regarded as a product of inadvertence or mistake." Id. at 753, 121 S.Ct. 1808.
- We note that other circuits have taken a similar approach in not rigidly adhering to the *New Hampshire* test (that is, considering different factors) when the party seeking to invoke judicial estoppel was not a party to the case in which the other party took an inconsistent position. *See, e.g., Stephenson v. Malloy,* 700 F.3d 265, 273 (6th Cir. 2012) (considering whether debtor who omitted lawsuit in bankruptcy disclosures had acted in bad faith); *Krystal Cadillac-Oldsmobile GMC Truck, Inc. v. Gen. Motors Corp.,* 337 F.3d 314, 325 (3d Cir. 2003) (considering, as part of judicial estoppel test, whether a lesser sanction would have remedied the damage done by the litigant's misconduct).
- 8 See Robinson v. Tyson Foods, Inc., 595 F.3d 1269, 1275-76 (11th Cir. 2010); De Leon v. Comcar Indus., Inc., 321 F.3d 1289, 1291-92 (11th Cir. 2003).
- 9 We emphasize that this list is not exhaustive; the district court is free to consider any fact or factor it deems relevant to the intent inquiry.
- 10 We do not overrule these cases entirely. Specifically, our decision today has no effect on the portion of Burnes holding that judicial estoppel did not apply to bar the debtor's injunctive relief claims, 291 F.3d at 1288-89, or the portions of

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- *Barger* addressing standing, estoppel, and the application of judicial estoppel to the debtor's claim for injunctive relief, 348 F.3d at 1292-93, 1297.
- 11 In 2015, 9.2% of Chapter 7 and 8.5% of Chapter 13 petitions nationwide were filed by debtors proceeding *pro se*. Michael B. Joseph, *Consumer Pro Se Bankruptcy: Finding Hope in Hopelessness*, 35 Am. Bankr. Inst. J. 32, 32 (May 2016).
- 12 Of course, the district court may determine that a plaintiff's testimony that he misunderstood the disclosure obligations is not credible.
- U.S. Steel argues that judicial estoppel is also necessary to protect the integrity of district courts from plaintiffs who pursue civil claims that they implicitly admitted in their bankruptcy proceedings were worthless. It posits that a plaintiff may omit a civil claim from his bankruptcy disclosures because he knew it was worthless, yet attempt to commit a fraud on the district court by trying to persuade the court that the claim has value. But under the rule we adopt today, a district court may apply judicial estoppel if it decides that the plaintiff intended to manipulate the judicial process in either court; it simply must consider the totality of the facts and circumstances before making that determination.
- 14 See also DelCostello v. Int'l Bros. of Teamsters, 462 U.S. 151, 162, 103 S.Ct. 2281, 76 L.Ed.2d 476 (1983) (explaining that principles of equity are hostile to "mechanical rules" (internal quotation marks omitted)); Baggett v. Bullitt, 377 U.S. 360, 375, 84 S.Ct. 1316, 12 L.Ed.2d 377 (1964) (explaining that whether a court should exercise its discretionary equitable powers should not depend on an "automatic rule").
- U.S. Steel contends that civil defendants receive no "pure windfall" if judicial estoppel is applied as the district court did here because they receive only the "incidental benefit" of escaping civil liability in exchange for providing the valuable service of "exposing abuses of the bankruptcy system." Appellee's Br. at 52-53 (internal quotation marks omitted). But only when the plaintiff intended to mislead is the defendant exposing an abuse of the system.

 In a similar vein, U.S. Steel argues that unless courts apply judicial estoppel consistent with our existing precedent, civil defendants will have no incentive to uncover omissions of civil lawsuits in bankruptcy filings, and such omissions will go undetected. Not so. Civil defendants like U.S. Steel will still have an incentive to research and discover whether the plaintiff failed to disclose a civil claim because the court may apply judicial estoppel if the facts and circumstances of the case show that the plaintiff had the requisite intent to deceive. In addition, the plaintiff's nondisclosure may provide fodder for cross examination and impeachment in the civil suit.
- As we observed above, our holding in *Parker* that judicial estoppel should not apply against a Chapter 7 trustee conflicted with *Barger*. Because we overrule that portion of *Barger*, *Parker* no longer conflicts with prior panel precedent, and so there is no question about its continued viability.
- See Spaine v. Cmty. Contacts, Inc., 756 F.3d 542, 548 (7th Cir. 2014) (reversing application of judicial estoppel because the civil defendant "needed to show more than an initial nondisclosure on a bankruptcy schedule"); Ah Quin v. Cty. of Kauai Dep't. of Transp., 733 F.3d 267, 276 (9th Cir. 2013) (rejecting a "presumption of deceit" where "the plaintiff-debtor has reopened the bankruptcy proceedings and has corrected the initial filing error"); Eubanks v. CBSK Fin. Grp., Inc., 385 F.3d 894, 899 (6th Cir. 2004) (reversing district court's application of judicial estoppel where plaintiffs omitted the claim because defendant "provide[d] no additional evidence that Plaintiffs demonstrated fraudulent intentions towards the court").
- See, e.g., Eastman v. Union Pac. R.R. Co., 493 F.3d 1151, 1157-60 (10th Cir. 2007) ("Where a debtor has both knowledge of the claims and a motive to conceal them, courts routinely, albeit at times sub silentio, infer deliberate manipulations."); In re Superior Crewboats, Inc., 374 F.3d 330, 335-36 (5th Cir. 2004) (concluding that judicial estoppel applied because plaintiffs knowingly omitted civil claim from bankruptcy disclosures).
- U.S. Steel also argues that stare decisis requires us to adhere to our precedent, but the en banc court may overrule panel decisions. See McKinney v. Pate, 20 F.3d 1550, 1565 n.21 (11th Cir. 1994) (en banc).

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In re Fundamental Long Term Care, Inc., 873 F.3d 1325 (2017)

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873 F.3d 1325 United States Court of Appeals, Eleventh Circuit.

IN RE: FUNDAMENTAL LONG TERM CARE, INC., Debtor.

Estate of Juanita Jackson, Estate of Elvira Nunziata, Estate of Joseph Webb, Estate of Arlene Townsend, Estate of Opal Lee Sasser, Estate of James Henry Jones, Plaintiffs—Appellants, Beth Ann Scharrer, Plaintiff,

v.

Rubin Schron, Defendant-Appellee.

No. 16-16462 | (October 19, 2017)

Synopsis

Background: Probate estates that had obtained prepetition judgments in wrongful death lawsuits against debtor, debtor's wholly owned subsidiary, and/or subsidiary's former parent company, together with Chapter 7 trustee, filed joint amended adversary complaint against subsidiary's former parent and shareholders, former parent's primary secured lenders, and several individuals and entities, including debtor, that allegedly received subsidiary's assets as part of a purported "bust-out scheme." Following dismissal of some of the claims without prejudice, 507 B.R. 359, plaintiffs filed second amended complaint, and defendants filed motions to dismiss. The United States Bankruptcy Court for the Middle District of Florida, No. 8:13-ap-00893-MGW, Michael G. Williamson, J., 512 B.R. 690, granted motion, and in subsequent proceeding, 569 B.R. 904, entered injunction against pursuit of claims against dismiss defendant in state court, and plaintiffs appealed. The District Court, No. 8:16-cv-00022-EAK, Elizabeth A. Kovachevich, J., 2016 WL 4718145, affirmed. Appeal was taken.

Holdings: The Court of Appeals, Julie Carnes, Circuit Judge, held that:

[1] a part of settlement of "clawback" claims, court had jurisdiction to permanently enjoin state court judgment

creditors from pursuing state law fraudulent transfer claims that arose out of same nucleus of operative fact against alleged participant in purported "bust out scheme";

- [2] permanent injunction to prevent judgment creditors from pursuing state court actions to collect on their judgments from alleged participant in purported "bustout scheme" was authorized under exceptions to Anti-Injunction Act;
- [3] complaint did not state plausible claim against this individual to hold him liable, as principal, for fiduciary breaches and other alleged misconduct by real estate attorney and investment banker;
- [4] complaint did not sufficiently allege a lack of "reasonably equivalent value" and did not state constructive fraudulent transfer claim that was plausible on its face;
- [5] complaint did not state abuse of process claim that was plausible on its face; and
- [6] bankruptcy court did not abuse its discretion when it dismissed, with prejudice, the second amended complaint filed by Chapter 7 trustee and judgment creditors against alleged participants in prepetition "bust out scheme."

Affirmed.

West Headnotes (27)

[1] Bankruptcy

Scope of review in general

In a bankruptcy appeal, the Court of Appeals functions as a second reviewer of the bankruptcy court's rulings and applies same standards as the district court, which provided first level of appellate review.

Cases that cite this headnote

[2] Bankruptcy

Conclusions of law; de novo review

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Court of Appeals reviews bankruptcy court's dismissal of pleading as failing to state a claim de novo, accepting factual allegations as true and construing them in light most favorable to plaintiff.

Cases that cite this headnote

[3] Bankruptcy

Conclusions of law; de novo review

Bankruptcy court's decision to issue an injunction under the All Writs Act is reviewed de novo. 28 U.S.C.A. § 1651(a).

Cases that cite this headnote

[4] Bankruptcy

Discretion

Court of Appeals reviews bankruptcy court's decision to grant or deny leave to amend a deficient pleading for abuse of discretion.

Cases that cite this headnote

[5] Bankruptcy

Issues between non-debtors

Bankruptcy courts lack subject matter jurisdiction over outside proceedings that do not affect the debtor. 28 U.S.C.A. § 1334(b).

Cases that cite this headnote

[6] Bankruptcy

Related proceedings

"Related to" jurisdiction of bankruptcy court extends to more than simply proceedings involving property of the debtor or of the estate. 28 U.S.C.A. § 1334(b).

Cases that cite this headnote

[7] Bankruptcy

Related proceedings

Bankruptcy court has "related to" jurisdiction over proceeding whose outcome could conceivably have any effect on estate being administered in bankruptcy. 28 U.S.C.A. § 1334(b).

Cases that cite this headnote

[8] Bankruptcy

Related proceedings

Bankruptcy court has "related to" jurisdiction to enjoin any civil action whose outcome could alter debtor's rights, liabilities, options, or freedom of action, or which in any way impacts upon handling and administration of bankruptcy estate. 28 U.S.C.A. § 1334(b).

Cases that cite this headnote

[9] Bankruptcy

Particular proceedings or issues

As part of settlement of "clawback" claims asserted by Chapter 7 trustee to bring fraudulently transferred assets into Chapter 7 estate, bankruptcy court had jurisdiction to permanently enjoin state court judgment creditors from pursuing state law fraudulent transfer claims that arose out of same nucleus of operative fact against individual who had been dismissed as defendant in "clawback" action prior to negotiation of settlement; such claims clearly implicated bankruptcy estate and had potential to deconstruct the bankruptcy court's resolution of dispute which was subject of settlement. 28 U.S.C.A. § 1334(b).

Cases that cite this headnote

[10] Courts

Injunction by United States Court Against Proceedings in State Court

Injunction is authorized under the All Writs Act if it falls within one of the Anti-Injunction Act's three exceptions. 28 U.S.C.A. §§ 1651, 2283.

Cases that cite this headnote

[11] Courts

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→ Injunction by United States Court Against Proceedings in State Court

Anti-Injunction Act exceptions are narrow and are not to be enlarged by loose statutory construction. 28 U.S.C.A. § 2283.

Cases that cite this headnote

[12] Courts

→ Injunction by United States Court Against Proceedings in State Court

Any doubts as to propriety of federal injunction against state court proceedings should be resolved in favor of permitting the state courts to proceed. 28 U.S.C.A. § 2283.

Cases that cite this headnote

[13] Courts

► Injunction by United States Court Against Proceedings in State Court

Anti-Injunction Act's third exception, the so-called "relitigation" exception, permits injunction of state court actions to protect or effectuate federal court judgments. 28 U.S.C.A. § 2283.

Cases that cite this headnote

[14] Courts

Injunction by United States Court Against Proceedings in State Court

Anti-Injunction Act's third exception, the socalled "relitigation" exception, is designed to implement well-recognized concepts of claim and issue preclusion. 28 U.S.C.A. § 2283.

Cases that cite this headnote

[15] Courts

Injunction by United States CourtAgainst Proceedings in State Court

Anti-Injunction Act's third exception, the socalled "relitigation" exception, is narrower than traditional principles of claim preclusion and authorizes an injunction to prevent state litigation only of a claim or issue that previously was presented to, and decided by, federal court. 28 U.S.C.A. § 2283.

Cases that cite this headnote

[16] Bankruptcy

State court proceedings

Courts

Debtor and creditor; bankruptcy; mortgages, liens, and security interests

Permanent injunction to prevent judgment creditors from pursuing state court actions to collect on their judgments from alleged participant in purported "bust-out scheme," who had been dismissed as defendant in "clawback" action brought by Chapter 7 trustee prior to negotiation of settlement with remaining defendants, was warranted, as to claims unsuccessfully asserted in bankruptcy court against this alleged participant in scheme, under "relitigation" exception to Anti-Injunction Act, and as to other claims which judgment creditors sought to pursue in state court, and which were not considered by bankruptcy court in "clawback" action, under Anti-Injunction Act's "in aid of the court's jurisdiction" exception. 28 U.S.C.A. § 2283.

Cases that cite this headnote

[17] Courts

► Injunction by United States Court Against Proceedings in State Court

State in personam proceedings that threaten to make complex multidistrict litigation unmanageable may be enjoined in aid of federal court's jurisdiction. 28 U.S.C.A. § 2283.

Cases that cite this headnote

[18] Courts

Injunction by United States Court Against Proceedings in State Court

To fall within the Anti-Injunction Act's second exception, the "in aid of the court's jurisdiction" exception, injunction must be necessary to prevent state court from so

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interfering with federal court's consideration or disposition of case as to seriously impair federal court's flexibility and authority to decide that case. 28 U.S.C.A. § 2283.

Cases that cite this headnote

[19] Principal and Agent

Complaint

Conclusory allegation that real estate attorney and investment banker, in orchestrating "bust out scheme" by which Chapter 7 debtor was stripped of its assets and essentially left as judgment-proof shell prior to commencement of its bankruptcy case, had done so as agents for individual with whom they enjoyed past professional relationship, with no allegation that this individual had ownership interest in any of entities involved in "bust out scheme," or that he profited financially from scheme, did not plausibly allege existence of agency relationship, as required to state claim against this individual to hold him liable, as principal, for fiduciary breaches and other alleged misconduct by real estate attorney and investment banker in connection with "bust out scheme."

Cases that cite this headnote

[20] Bankruptcy

Pleading

Allegations in complaint filed by Chapter 7 trustee and judgment creditors, regarding settlement agreement whereby receiver for bankrupt subsidiary's former parent assigned all of the claims that receivership estate had against any third parties, including legal malpractice claims, in exchange for \$700,000 payment, did not sufficiently allege a lack of "reasonably equivalent value" and did not state constructive fraudulent transfer claim that was plausible on its face; complaint alleged in conclusory terms that claims were worth the full amount of "empty chair" judgments that were the subject of pending appeals, with no consideration of costs of

collection or of likelihood of success on appeal.

Cases that cite this headnote

[21] Bankruptcy

reasonably equivalent value' in general

"Reasonably equivalent value," for constructive fraudulent transfer avoidance purposes, does not mean dollar-for-dollar equivalence; instead, courts make informed judgments as to asset valuation in light of the totality of the circumstances. 11 U.S.C.A. § 548(a)(1)(B).

Cases that cite this headnote

[22] Bankruptcy

Proceedings; Motion or Sua Sponte Action

Allegations in complaint filed by Chapter 7 trustee and judgment creditors, that representation of corporate defendant by individual defendants' counsel was unauthorized and that individual defendants misled various state courts with respect to nature of corporate defendant's defense, did not allege that civil process had been employed for purpose for which it was not intended and did not state abuse of process claim that was plausible on its face.

Cases that cite this headnote

[23] Process

Nature and elements in general

Under Florida law, abuse of process involves the use of criminal or civil legal process against another primarily to accomplish a purpose for which it was not designed.

Cases that cite this headnote

[24] Process

Misuse of process

Under Florida law, mere fact that party may be motivated by incidental or concurrent benefits of use of process is not sufficient

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to constitute an abuse of process; abuse of process has not occurred unless process is used to accomplish an immediate purpose other than that for which it was designed.

Cases that cite this headnote

[25] Torts

Litigation privilege; witness immunity

Florida litigation privilege affords immunity to allegedly tortious acts occurring during the course of a legal proceeding, as long as they have some relation to the legal proceeding.

Cases that cite this headnote

[26] Federal Civil Procedure



Dismissal of claims with prejudice to party's ability to file an amended pleading is generally not an abuse of discretion, where future amendments would be futile or unfairly prejudicial.

Cases that cite this headnote

[27] Bankruptcy

Pleading;dismissal

Bankruptcy court did not abuse its discretion when it dismissed, with prejudice, the second amended complaint filed by Chapter 7 trustee and judgment creditors against alleged participants in prepetition "bust out scheme," whereby debtor was stripped of its valuable assets prior to commencement of its bankruptcy case, where plaintiffs had been given multiple opportunities to plead all the claims that could plausibly have arisen out of this alleged "bust out scheme," and second amended complaint did not correct errors identified by court in dismissing prior complaint, but simply reasserted claims that had previously been dismissed; bankruptcy court could reasonably conclude that further amendment was futile.

Cases that cite this headnote

*1328 Appeal from the United States District Court for the Middle District of Florida, D.C. Docket Nos. 8:16cv-00022-EAK & 8:11-bkc-22258-MGW

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Before JORDAN and JULIE CARNES, Circuit Judges, and VINSON, * District Judge.

Opinion

JULIE CARNES, Circuit Judge:

This case has a complex procedural history lasting more than a decade and spanning several state and federal venues. It began when the estates of several deceased nursing-home patients (the "Estates" or "Appellants") brought a series of wrongful-death suits against a network of nursing homes. These suits collectively resulted in \$1 billion in empty-chair judgments against the network. In an effort to evade enforcement of these and other liabilities, the defendant entities orchestrated a so-called "bust out" scheme under which they transferred the useful assets of the nursing-home business into a newly formed operating entity, leaving the core judgment debtor a judgment-proof shell company.

When the Estates learned that this judgment debtor had been stripped of its assets, they filed an involuntary Chapter Seven bankruptcy petition in the Middle District of Florida and initiated an adversary proceeding seeking to avoid, as fraudulent, the transfer of the debtor's assets. The complaint named seventeen entities and individuals as defendants and described a wide-reaching scheme in which assets were secretly diverted in order to hinder, delay, and defraud the debtor's various judgment creditors. One

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of the named defendants was real-estate investor Rubin Schron.

After careful consideration of the Estates' thirty-two claims for relief—and after granting the Estates an opportunity to comprehensively amend their lengthy and deficient initial complaint—the bankruptcy court dismissed Schron from the suit, concluding that his alleged connection with the transaction was speculative at best. Claims against several additional defendants survived dismissal, and the case culminated in a twelve-day bench trial. At its conclusion, the Estates settled with the remaining defendants for \$24 million. The bankruptcy court approved the settlement as fair and equitable on the condition that the Estates be permanently enjoined from pursuing any additional claims arising from the bust-out scheme against Schron individually.

The Estates appealed the dismissal of claims against Schron and the bankruptcy court's issuance of a permanent injunction with respect to Schron. The district court for the Middle District of Florida affirmed both orders. The Estates now appeal those orders to this Court. After careful review, and with the benefit of oral argument, we affirm.

BACKGROUND

Although this appeal relates solely to the Estates' claims against Appellee Rubin *1330 Schron, the scope of the allegations against him requires us to review in some detail the underlying transaction and the course of proceedings before the bankruptcy court. ¹

I. The March 2006 Transaction

Trans Healthcare, Inc. ("THI") was founded in 1998 to operate nursing homes, assisted living facilities, and long-term acute-care hospitals throughout the United States. Trans Healthcare Management, Inc. ("THMI") was a wholly owned subsidiary of THI and provided management services to THI until March 2006. By early 2006, numerous wrongful-death and negligence actions had been filed against THI and THMI on behalf of several nursing-home patients who had died while in THI and THMI's care.

Anticipating adverse judgments, the entities designed a transaction that would shield their assets from potential creditors without affecting their profitable operations (the "2006 Transaction"). Under the direction of Leonard Grunstein, a former real-estate lawyer, and Murray Forman, an investment banker, two new entities were created: Fundamental Long Term Care, Inc. ("FLTCI") and Fundamental Long Term Care Holdings ("FLTCH") (together, the "Fundamental Entities"). In the first phase of the transaction, THMI sold all its assets to FLTCH for \$9.9 million. In the second phase, THI sold all its stock in the stripped-down THMI to FLTCI. FLTCI therefore acquired all of THMI's liabilities but none of its assets.

THI remained an active corporation and continued operating nursing homes on a small scale following the transaction. It was ultimately placed into a receivership and wound down. THMI continued to exist as an insolvent subsidiary and the sole asset of FLTCI; both entities quickly became defunct. FLTCH, on the other hand, was left with a substantial number of productive assets and continued operating the entities' broader network of nursing homes, generating millions of dollars of income, without being saddled with the millions of dollars in liabilities attributable to those entities. To keep the network running, FLTCH rebranded the former THI/ THMI facilities and created two new subsidiaries: FCC, which provided operational and clinical support; and FAS, the administrative arm of the company. Together, FLTCH, FCC, and FAS continued to operate in the same locations, and used the same employees and equipment, as did THI and THMI prior to the 2006 Transaction. At all relevant times, FLTCH was owned by Grunstein and Forman.²

As noted, the Estates' complaint made allegations concerning Rubin Schron's involvement in the above-described 2006 Transaction. Schron is a wealthy New York real-estate investor whose involvement with the THI network began in 2002. *1331 That year, Grunstein and Forman—Schron's lawyer and banker, respectively—allegedly convinced Schron to fund the acquisition of 120 nursing homes from an unrelated entity that was in the process of Chapter Eleven liquidation. The acquisitions were executed by an entity called ABE Briarwood, and the facilities were subsequently leased to THI. The complaint does not allege that Schron ever held a direct ownership interest in THI, THMI, or FLTCH. Similarly, there is no allegation that Schron was involved in designing

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or executing the 2006 Transaction. The Estates allege only that Schron was aware of Grunstein and Forman's involvement in the 2006 Transaction and that Grunstein and Forman acquired stakes in FLTCH as Schron's agents, but as to this last allegation, the Estates articulate no basis for their conclusory assertion of an agency relationship.

II. The Wrongful-Death Judgments

In the meantime, the estates of six deceased nursing-home patients pursued wrongful-death actions against THI and THMI in state court, alleging that the decedent patients had been abused, neglected, and injured by the negligent and reckless operation of THI's nursing homes in Florida and Pennsylvania. The Estates had no knowledge at the time that the named defendants, THI and THMI, had been stripped of their assets.

To ensure that the Estates were kept in the dark, FLTCH's goal was to use the THI receivership to conceal the linked transfers long enough for the statute of limitations to run on any available fraudulent-transfer claims. In furtherance of this plan, THI directed its counsel to withdraw representation of THI and THMI at around the same time as the relevant statutes of limitations ran. The liability proceedings moved forward, and the various state courts in which these claims were pending ultimately entered "empty-chair" jury verdicts (that is, verdicts not contested by the defendants) against THI and THMI totaling more than \$1 billion.

Despite FLTCH's efforts at concealment, the Estates eventually learned of the 2006 Transaction and the formation of the successor Fundamental Entities. They responded by initiating supplementary state-court proceedings against various entities and individuals alleged to have fraudulently transferred the FLTCH assets out of creditors' reach. THI, THMI, the Fundamental Entities, Grunstein, Forman, and Schron were specifically targeted. The Estates also initiated an involuntary Chapter Seven bankruptcy proceeding, naming FLTCI as debtor. A Trustee was appointed, and the Estates were identified as FLTCI's chief creditors.

Shortly after the Chapter Seven proceeding began, the Trustee expressed her intent to pursue fraudulent-transfer and related actions under the Bankruptcy Code against FLTCH and other entities involved in the 2006 Transaction. This cause of action overlapped with the

Estates' already ongoing judgment-enforcement actions, which were based primarily on state-law fraudulent-transfer theories. In order to fend off these simultaneous actions, FLTCH filed a declaratory-judgment action in a New York court seeking a declaration that any fraudulent-transfer or similar claims relating to the 2006 Transaction were barred by the statute of limitations. The bankruptcy court enjoined the declaratory-judgment action after concluding that it would impermissibly interfere with the Trustee's ability to administer the Chapter Seven proceeding and protect the assets of the estate.

*1332 Having lost its bid for a New York declaratory judgment, FLTCH then sought an order from the bankruptcy court temporarily enjoining the Estates from pursuing their state-court judgment-enforcement actions. The bankruptcy court agreed that a multiplicity of parallel actions could lead to inconsistent outcomes and therefore entered an order establishing that all fraudulent-transfer and similar claims against the various defendants designed to unwind the 2006 Transaction would be litigated in a single adversary proceeding before the bankruptcy court (the "Venue Order"). The result was that all pending state actions were enjoined pending resolution of the Chapter Seven adversary proceeding.

III. The Adversary Proceeding

Following the bankruptcy court's Venue Order, the Estates initiated an adversary proceeding with a twocount complaint for declaratory judgment, naming THI, THMI, the Fundamental Entities, Grunstein, Forman, and Schron as defendants (collectively, the "Defendants"), in addition to several other entities involved in the transaction. In Count I, the Estates sought a declaration that FLTCH and FLTCI were liable for the judgments against THI and THMI under a successor theory of liability. In Count II, they sought a declaration that Defendants were directly liable for the judgments against THI and THMI under a veil-piercing theory. The Trustee intervened in that proceeding to add a count for substantive consolidation of FLTCI and THMI. The Estates and the Trustee were later granted leave to amend the initial complaint and join their respective claims.

A. First Amended Complaint

In December 2013, the Estates and Trustee (together, "Plaintiffs") filed an enhanced First Amended Complaint

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—a 228-page tome containing 1,201 numbered paragraphs and twenty-two counts against Defendants and several additional entities. The twenty-two counts in the complaint can be broken into eight substantive claims for relief: one count for substantive consolidation of FLTCI and THMI; two counts for breach of fiduciary duty; four counts for aiding and abetting a breach of fiduciary duty; one count for successor liability; two counts for piercing of the corporate veil; three counts for alter-ego liability; eight counts for actual and constructive fraudulent transfer; and one count for conspiracy to commit a fraudulent transfer. Asserting theories of direct or derivative liability, Plaintiffs' goal was to "unwind" the 2006 Transactions and recapture the FLTCH assets wherever they may be held—in order to satisfy the Estates' various judgments against the THI/THMI network.

Defendants moved to dismiss all but the substantiveconsolidation count. In a thorough opinion, the bankruptcy court upheld several counts against several defendants and dismissed several without prejudice, granting leave to amend. See Estate of Jackson v. Gen. Elec. Capital Corp. (In re Fundamental Long Term Care, Inc.), 507 B.R. 359, 386 (Bankr. M.D. Fla. 2014). Specifically, the court allowed the claims for fraudulent transfer against FLTCH, Forman, and Grunstein to go forward, declining to enforce the statute of limitations on those claims in light of allegations that these defendants had intentionally concealed facts that would have given rise to the claim within the limitations period. As to the remaining claims, the bankruptcy court found the allegations "confusing, ambiguous, generalized, [and] conclusory," and noted overall that the pleading required "considerable energy to read." *1333 *Id.* at 385– 86 (internal quotation marks omitted). The court was nonetheless "not ready to conclude that the Plaintiffs could not allege additional facts that may potentially give rise to the causes of action the Court is dismissing." Id. at 386. The court instructed Plaintiffs to amend again and cure the pleading defects. Id.

B. Second Amended Complaint

Plaintiffs filed their Second Amended Complaint in April 2014. Instead of clarifying their initial slate of allegations and rehabilitating the dismissed claims, as they were directed to do, the Second Amended Complaint incorporated several hundred paragraphs of the First Amended Complaint by reference and offered a new, but largely repetitive, restatement of several claims. It then

added four brand-new claims against several defendants. With only two exceptions, the bankruptcy court dismissed with prejudice each of the newly pled and re-pled claims, citing the same defects identified in the first motion to dismiss.

The court concluded that it was appropriate to dismiss the failed claims with prejudice because "any further attempts by Plaintiffs to amend their complaint would be futile or unfairly prejudicial to the Defendants." On that point, the court observed that, as a result of the parallel judgment-enforcement actions the Estates had already pursued in various state courts, Plaintiffs "had the benefit of almost complete discovery before filing their second amended complaint."

Most relevant to this appeal are the court's conclusions as to the claims against Schron. Plaintiffs attempted in their Second Amended Complaint to revive each of their original counts against Schron and to add four more: alter-ego liability; aiding and abetting a breach of fiduciary duty; abuse of process; conspiracy to commit abuse of process; negligence; constructive fraud; and improper post-petition transfer. The court dismissed each claim in turn, emphasizing the overarching flaw in the Plaintiffs' narrative: "[N]owhere in the complaint ... is Schron alleged to have committed *any* act individually," nor did the allegations support a theory of derivative liability against Schron.

The court followed its decision with a final judgment in favor of Schron (the "Dismissal"), in which it stated that "[f]inal judgment is entered in favor of Schron on all claims that were or could have been asserted by Plaintiffs against him in the amended complaint and the second amended complaint."

C. Subsequent Proceedings

Schron was the only defendant fully dismissed from the adversary proceeding at the pleading stage. Three additional defendants were dismissed later via their motions for summary judgment. In the course of pretrial proceedings, the bankruptcy court also granted Plaintiffs' motion to substantively consolidate THMI with the Chapter Seven debtor, FLTCI. The bankruptcy court then proceeded to consider the surviving claims during a twelve-day bench trial. At issue in the bench trial were claims against Grunstein, Forman, and several related entities for breach of fiduciary duty, aiding and abetting

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breach of fiduciary duty, successor liability, fraudulent transfer, and conspiracy to commit fraudulent transfer.

At the conclusion of trial, the bankruptcy court dismissed claims against three additional defendants but remained "unsure" *1334 as to "which of the Defendants on the buyers' side [of the 2006 Transaction] would be liable" under a successor liability theory, which was the only remaining theory under which Plaintiffs could prevail. The court announced findings of fact and conclusions of law following trial and then ordered Plaintiffs and the remaining defendants, including FLTCH, Forman, and Grunstein, to mediate in hopes that a settlement could be reached.

Mediation was successful and ultimately yielded five settlement agreements. Under these agreements, Plaintiffs agreed to accept \$18.5 million from FLTCH, FAS, THI, Forman, and Grunstein; \$1.25 million from one of the law firms that defended THI and THMI against the Estates' earlier actions; \$3.25 million from three additional entities involved in the 2006 Transaction; and \$700,000 from THI's state-court receiver. In total, these agreements yielded \$23.7 million to cover Plaintiffs' damages.

Having earlier been dismissed from the adversary proceeding at the pleading stage, Schron was the sole non-settling Defendant. Throughout the adversary proceeding, the Estates had maintained their intention to pursue further state actions against Schron notwithstanding his early dismissal from the case. Schron recognized the possibility of future action against him in a different venue and accordingly opposed the various settlements unless they were accompanied by a permanent injunction preventing the Estates from reviving or bringing any new state-court judgment-enforcement actions against him. Thus, Schron's insistence on a permanent injunction reflected his legitimate fear that Plaintiffs would try to upend the resolution reached by the bankruptcy court after much litigation by the parties.

Likewise concerned that Plaintiffs would attempt to undo the final resolution that had been the goal of the complex and protracted adversary proceeding, the bankruptcy court issued a permanent injunction (the "Permanent Injunction" or "Injunction") prohibiting Plaintiffs from "pursuing claims against Rubin Schron arising out of the nucleus of facts set forth in the adversary complaint in this proceeding." This injunction was integral to and a condition of the court's approval of the settlements, as the court determined that a settlement of the surviving claims could not be "fair and equitable" if it did not also finally resolve the claims against Schron. In the bankruptcy court's view, an injunction prohibiting further litigation against Schron in another forum was "necessary" to protect the court's prior judgment as to Schron. The court granted this permanent injunction in December 2015 and then, after approving each of the settlement agreements, issued an opinion thoroughly discussing the basis for the Injunction and the authority on which it was issued.

The Estates appealed the Dismissal and the Permanent Injunction as to Schron to the Middle District of Florida, which affirmed both orders of the bankruptcy court. The Estates now appeal the district court's affirmance, asking this Court to reverse the bankruptcy court's orders with respect to Schron.

STANDARD OF REVIEW

[1] [2] [4] In a bankruptcy appeal, this Court functions as a second reviewer of the bankruptcy court's rulings and applies the same standards as the district court, which operates as the first level of appellate review. Brown v. Gore (In re Brown), 742 F.3d 1309, 1315 (11th Cir. 2014). We therefore review a lower court's dismissal *1335 of a pleading for failure to state a claim de novo, accepting factual allegations as true and construing them in the light most favorable to the plaintiff. Almanza v. United Airlines, Inc., 851 F.3d 1060, 1066 (11th Cir. 2017). A lower court's decision to issue an injunction under the All Writs Act, 28 U.S.C. § 1651(a), is also reviewed de novo. SFM Holdings, Ltd. v. Banc of Am. Secs., LLC, 764 F.3d 1327, 1334 (11th Cir. 2014). We review a court's decision to grant or deny leave to amend a deficient pleading for abuse of discretion. Troville v. Venz, 303 F.3d 1256, 1259 (11th Cir. 2002).

DISCUSSION

The Estates ask us to review the bankruptcy court's Permanent Injunction as to Schron as well as its Dismissal of all claims alleged in the First and Second Amended Complaints against Schron. We consider each of the Estates' challenges in turn.

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I. Grant of Permanent Injunction

The Estates urge this Court to reverse the bankruptcy court's Permanent Injunction of any claims against Schron "arising out of the nucleus of facts set forth" in the Estates' Second Amended Complaint on two grounds: that the bankruptcy court lacked jurisdiction to enjoin state-law claims; and that, even if it had jurisdiction, the Permanent Injunction exceeded the court's authority under the All Writs Act and the Anti-Injunction Act. We have considered these challenges *de novo* and conclude that the Permanent Injunction was properly issued.

It is important first to clarify the scope of the Permanent Injunction, which is broad. By its language, the Injunction covers three categories of claims: (1) any claims against Schron "arising out of the nucleus of facts set forth" in the Second Amended Complaint; (2) the Estates' pending state-court judgment-enforcement actions against Schron, which had been temporarily enjoined pending resolution of the adversary proceeding; and (3) any claims against Schron "as the 'real party in interest' " in three pending state-court cases involving three of the Estates. Thus, in addition to enjoining claims that the Estates had already unsuccessfully pled against Schron in their Second Amended Complaint (the "Dismissed Claims"), 3 the Injunction precludes the Estates from pursuing any new or old state or federal actions against Schron asserting any claim arising from the 2006 Transaction, including claims the Estates did not specifically raise in the adversary proceeding.

The Estates identify three types of claims that were not resolved through the adversary proceeding and were thus improperly foreclosed by the Injunction: proceedings supplementary under *1336 Florida Statutes § 56.29; 4 "real party in interest" claims under state law; 5 and actions under 42 U.S.C. § 1983 6 (collectively, the "Potential Claims"). The Estates argue that the Potential Claims are theoretically distinct from the Dismissed Claims and thus were improperly swept into the Permanent Injunction.

A. Subject-Matter Jurisdiction

The Estates first argue that the bankruptcy court lacked jurisdiction to issue the Permanent Injunction. We begin by outlining the legal principles that define the bankruptcy court's power to enjoin proceedings in foreign venues.

Any power by the bankruptcy court to issue the Permanent Injunction against non-bankruptcy proceedings must necessarily derive from the federal bankruptcy jurisdictional statute, 28 U.S.C. § 1334. In relevant part, this statute provides that bankruptcy courts "shall have original ... jurisdiction" over "all civil proceedings arising under title 11, or arising in or related to cases under title 11," § 1334(b), and "all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate," § 1334(e) (1). The bankruptcy court's jurisdiction over cases "arising in or related to" a bankruptcy proceeding is sometimes referred to as "related-to jurisdiction" and is the focus of our analysis on appeal.

[5] [6] Bankruptcy courts plainly lack jurisdiction over outside proceedings that do not affect the debtor. *Celotex Corp. v. Edwards*, 514 U.S. 300, 309 n. 6, 115 S.Ct. 1493, 131 L.Ed.2d 403 (1995). But the phrase "related to"—which is not defined in the Bankruptcy Code—"must be read to give [bankruptcy courts] jurisdiction over more than simply proceedings involving the property of the debtor or the estate." *Id.* at 308, 115 S.Ct. 1493; *see also id.* at 307–08, 115 S.Ct. 1493 ("Congress did not delineate the scope of 'related to' jurisdiction, but its choice of words suggests a grant of some breadth." (footnote omitted)).

[7] The Third Circuit has held that a civil proceeding is " 'related to' a [bankruptcy] proceeding if the outcome of [the] proceeding could conceivably have any effect on the estate being administered in bankruptcy." Nuveen Mun. Trust ex rel. Nuveen High Yield Mun. Bond Fund v. WithumSmith Brown, P.C., 692 F.3d 283, 293-94 (3d Cir. 2012) (second alternation in original) (emphasis in original) (quoting Pacor Inc. v. Higgins, 743 F.2d 984, 994 (3d Cir. 1984)) (internal quotation marks omitted). We have indicated our agreement with that principle. *1337 Miller v. Kemira, Inc. (In re Lemco Gypsum, Inc.), 910 F.2d 784, 788 (11th Cir. 1990) ("We join the majority of the circuits that have adopted the Pacor formulation."); see also Celotex, 514 U.S. at 308, 115 S.Ct. 1493 (agreeing "with the views expressed by the Court of Appeals for the Third Circuit in [*Pacor*], that 'Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate' "); Wortley v. Bakst, 844 F.3d 1313, 1320 (11th Cir. 2017) (applying the "conceivable effect"

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test from *Lemco Gypsum* to conclude that the bankruptcy court had related-to jurisdiction over certain state-law tort claims).

[8] [9] Under this standard, a bankruptcy court can enjoin any civil action "if the outcome could alter the debtor's rights, liabilities, options, or freedom of action" or "in any way impacts upon the handling and administration of the bankrupt estate." *Celotex*, 514 U.S. at 308 n.6, 115 S.Ct. 1493 (quoting *Pacor*, 743 F.2d at 994) (internal quotation marks omitted); *see also Wortley*, 844 F.3d at 1318–20. The overriding question, then, is whether the claims covered by the Permanent Injunction could "conceivably" affect the administration of the bankruptcy estate, especially in light of the substantive consolidation of FLTCI (the named debtor) and THMI (the Estates' chief judgment debtor). We conclude that they could.

Consider the simple example of a state-law judgment under Florida Statutes § 56.29 determining that Schron was the recipient of a fraudulent transfer from THMI and is thus liable, to the extent of that transfer, for the Estates' wrongful-death judgments against THMI. If, pursuant to that judgment, Schron were ordered to disgorge any prior transfer of assets, then the sum transferred would necessarily reenter, and enlarge, the joint FLTCI/THMI bankruptcy estate. It is clear that such an outcome would, at the least, "conceivably" impact the size and the administration of the estate.

The Estates ask us to focus on a somewhat more complicated example: an action to avoid (that is, undo) fraudulent transfers from THI, which is THMI's former parent and the Estates' secondary judgment creditor. The Estates assert that certain of the claims they wish to bring against Schron "are individual, grounded in state law and [] designed to collect on the Estates' judgments against THI—an entity that 'has not been substantively consolidated into the Debtor, [or] determined to be the alter ego of or successor to the debtor.' "According to the Estates, because THI is an entirely separate entity from debtors THMI and FLTCI, any action seeking to hold Schron liable for the Estates' judgments against THI will have "no conceivable impact" on the property of the debtor's estate.

We disagree. As noted, the Estates wish to pursue fraudulent transfer claims under state law, with the goal of recovering assets that were transferred by THI through FLTCI and, finally, to FLTCH. If a state court were to find those transfers to be non-fraudulent, then the FLTCI estate would have a hard time succeeding on its own fraudulent-transfer claim against FLTCH. In other words, because THI was the entity from which the 2006 Transaction originated, a finding in state court that THI's transfers were not fraudulent would undermine the debtor's central avoidance claim against FLTCH-the primary transferee of THI's assets. Such a result would no doubt impact the size of the estate and the parties' various efforts to reverse the *1338 2006 Transaction. Significant repercussions would likewise result from a state-court judgment establishing that the transfers from THI were, indeed, fraudulent and avoidable under state law and that Schron himself, as an alleged recipient of assets from FLTCH, was liable for the wrongful-death judgments against THI. In that case, the debtor's avoidance claims against FLTCH would be strengthened by the possibility of recovery against Schron himself as a downstream transferee. ⁷ In other words, the assets that would satisfy the Estates' judgments against THI necessarily flowed through THMI-and therefore through FLTCI, and therefore through the bankruptcy estate—before reaching Schron. Any assets transferred to Schron would have to pass back through the bankruptcy estate before they could be used to satisfy the Estates' wrongful-death judgments. The structure of the transaction makes it impossible to envision an action seeking recovery from Schron for the THI debts that would not implicate the THMI estate and carry the potential to deconstruct the bankruptcy court's resolution of the dispute.

The Estates have identified no scenario in which a claim to recover on a judgment against THI would not impact the size and administration of the bankruptcy estate, as well as the debtor's potential claims with respect to the 2006 Transaction. As a result, we conclude the bankruptcy court possessed subject-matter jurisdiction under § 1334(b) to enjoin claims against Schron arising from the 2006 Transaction.

B. Authority under the All Writs Act

The next question the Estates ask us to consider is whether the bankruptcy court had statutory authority to enjoin pending and future state-court proceedings under the particular circumstances of this case.

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[12] The bankruptcy court justified the to implement well-recognized concepts of claim and [10]Permanent Injunction under the All Writs Act, 28 U.S.C. § 1651, which states that federal courts "may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law." 28 U.S.C. § 1651(a). Authority under the All Writs Act is limited by the Anti-Injunction Act, which provides:

A court of the United States may not grant an injunction to stay proceedings in a State court except [1] as expressly authorized by Act of Congress, or [2] where necessary in aid of its jurisdiction, or [3] to protect or effectuate its judgments.

28 U.S.C. § 2283. If an injunction falls within one of the Anti-Injunction Act's three exceptions, then it is authorized under the All Writs Act. See Burr & Forman v. Blair, 470 F.3d 1019, 1028 (11th Cir. 2006) ("[T]he sole relevant inquiry is whether the injunction qualifies for one of the exceptions to the Anti-Injunction Act."). The Anti-Injunction Act exceptions "are narrow and are not [to] be enlarged by loose statutory construction." SFM Holdings, 764 F.3d at 1335 (alternation in original) (quoting *1339 Smith v. Bayer Corp., 564 U.S. 299, 131 S.Ct. 2368, 2375, 180 L.Ed.2d 341 (2011)) (internal quotation marks omitted). As such, "[a]ny doubts as to the propriety of a federal injunction against state court proceedings should be resolved in favor of permitting the state courts to proceed." Id. (alternation in original) (quoting Smith, 131 S.Ct. at 2375) (internal quotation marks omitted).

The bankruptcy court concluded that the Permanent Injunction was "necessary in aid of its jurisdiction" and necessary "to protect or effectuate its judgments" under the second and third Anti-Injunction Act exceptions. The district court agreed with the bankruptcy court's rationale, finding that "the Bankruptcy Court's injunction clearly seeks to protect the integrity or enforceability of its existing orders, i.e. its order dismissing the Bankruptcy Estates' claims against Schron, as well as the settlement agreement between the Probate Estates, the Trustee, and the remaining defendants." We agree.

[13] [14] [15] The Anti-Injunction Act's third exception, often called the "relitigation exception," permits injunction of state-court actions "to protect or effectuate [the federal court's] judgments." See SFM Holdings, 764 F.3d at 1335. This exception "is designed

issue preclusion." Id. (quoting Smith, 131 S.Ct. at 2375) (internal quotation marks omitted). We have, however, acknowledged that "the relitigation exception is narrower" than traditional principles of claim preclusion and "only authorizes an injunction to prevent state litigation of a claim or issue that previously was presented to and decided by the federal court." Id. at 1336 (quoting Smith, 131 S.Ct. at 2375) (internal quotation marks omitted).

[16] Given this framework, there is no question that the Injunction was proper under the third Anti-Injunction Act exception as to the Dismissed Claims—i.e., the claims specifically asserted in the Second Amended Complaint against Schron. These matters were "presented to and decided by" the bankruptcy court when it considered and dismissed the Second Amended Complaint with prejudice as to Schron.

The Potential Claims, on the other hand, were not asserted in the Second Amended Complaint and thus were not decided by the bankruptcy court. While the relitigation exception is therefore not applicable, we conclude that an injunction directed against the Potential Claims was "necessary in aid of [the court's] jurisdiction" under the second Anti-Injunction Act exception.

[18] We have consistently held that "state in personam proceedings that threaten to make complex multidistrict litigation unmanageable" may be enjoined in aid of the court's jurisdiction. Juris v. Inamed Corp., 685 F.3d 1294, 1339 (11th Cir. 2012) (internal quotation marks omitted); see also Estate of Brennan ex rel. Britton v. Church of Scientology Flag Serv. Org., Inc., 645 F.3d 1267, 1274 (11th Cir. 2011). To fall within this exception, the injunction must be "necessary 'to prevent a state court from so interfering with a federal court's consideration or disposition of a case as to seriously impair the federal court's flexibility and authority to decide that case." Wesch v. Folsom, 6 F.3d 1465, 1470 (11th Cir. 1993) (quoting Atl. Coast Line R.R. Co. v. Bhd. of Locomotive Eng'rs, 398 U.S. 281, 295, 90 S.Ct. 1739, 26 L.Ed.2d 234 (1970)). For instance, in Battle v. Liberty National Life Insurance Co., we held that a district court that had issued a final judgment in a complex and lengthy class action, and expressly retained jurisdiction over the settlement, *1340 properly enjoined a subsequent statecourt suit involving substantially similar claims. 877 F.2d

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877, 880–83 (11th Cir. 1989). The underlying case involved "years of litigation and mountains of paperwork," and we concluded that any future state-court judgment "would destroy the settlement" the parties had reached and "nullify [the] court's work in refining its Final Judgment" while "subject[ing] the parties to added expense and conflicting orders." *Id.* at 882 (internal quotation marks omitted).

We agree with the bankruptcy court that "[t]his case, although not involving a class action or multi-district litigation, falls squarely within the Eleventh Circuit's decisions in *Battle*" and subsequent, similar cases. *See, e.g., Wesch,* 6 F.3d at 1470–71 (affirming injunction on finding that "virtual equivalent of a *res* to be administered" existed where the district court had "invested a great deal of time and other resources in the arduous task of reapportioning Alabama's congressional districts"); *Juris,* 685 F.3d at 1339–40 (concluding that "paradigmatically complex" litigation that ended in carefully crafted settlement "presumptively satisfie[d]" the second Anti-Injunction Act exception under *Battle* and *Wesch*).

The bankruptcy court's description of the course of proceedings in this matter merits repeating:

What started off as six negligence or wrongful death lawsuits has morphed into 25 lawsuits (including adversary proceedings) and 15 appeals before 11 courts and 17 judges in five states over 11 years.... [I]t quickly became apparent the Probate Estates and Trustee were pursuing identical claims against identical parties arising out of the same nucleus of operative facts—i.e., the March 2006 transactions—in more than one forum (state court, district court, and bankruptcy court)....

This Court (and others) have devoted years of time and effort to this exceedingly complex litigation. ... The complaints in this proceeding ... totaled nearly 300 pages and contained more than 1,600 numbered paragraphs [and] alleged 32 claims for relief against 17 parties.... The mediation produced four settlements that will bring nearly \$24 million into the bankruptcy estate ... and, perhaps more important, resolve this adversary proceeding and bankruptcy case in their entirety.

The scale of this proceeding, the broad scope of the Estates' claims in the First and Second Amended Complaints, and the fact that the Estates have had several opportunities to develop their claims against Schron justify the court's injunction of actions that will raise claims substantially similar, if not identical, to the claims that have been dismissed.

It is also important to note that the bankruptcy court's approval of the settlements as fair and equitable was expressly conditioned on the issuance of the Permanent Injunction. In the bankruptcy court's view, a broad settlement agreement that left the door open to state actions alleging analogous claims against Schron would "unduly prejudice[] Schron." The bankruptcy court's careful consideration of the Estates' claims and substantial efforts in reaching a fair, equitable, and comprehensive resolution of this matter would be undone by future state-court adjudications raising the same claims. And because the Estates have been unequivocal about their intent to pursue state action against Schron, the necessity of the Injunction in aid of the bankruptcy court's jurisdiction is clear.

*1341 We thus agree with the lower courts that the injunction of state-court claims against Schron "arising out of the nucleus of facts set forth" in the Second Amended Complaint was authorized under the All Writs Act. We therefore conclude that the bankruptcy court properly issued the Permanent Injunction as to Schron, and we AFFIRM the decisions of both lower courts on these issues.

II. <u>Dismissal of Second Amended Complaint with</u> Prejudice

The Estates also challenge the bankruptcy court's order of final dismissal as to Schron, arguing that the courts below failed to properly analyze allegations that Schron (1) is an alter ego of debtor FLTCI; (2) aided and abetted a breach of fiduciary duty by the board of directors of THMI; (3) committed and benefited from fraudulent transfers of the assets of THI and THMI, thus committing constructive fraud; and (4) committed abuse of process and conspired to commit abuse of process. If their arguments as to the merits of these claims fail, the Estates ask this Court to reverse the bankruptcy court's decision to dismiss with prejudice and provide them another opportunity to amend their complaint.

We agree with the courts below that the Second Amended Complaint failed to sufficiently allege any causes of action

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against Schron personally, and we find no abuse of discretion in the bankruptcy court's decision to dismiss those claims with prejudice.

A. Sufficiency of the Allegations

The Estates wish to revive several distinct claims against Schron that the bankruptcy court dismissed. We discuss each in turn, taking the factual allegations contained in the Second Amended Complaint as true and construing them in the light most favorable to the Estates.

1. Claims Arising from the 2006 Transaction

[19] Importantly, there is no allegation in the Complaint that Schron took any affirmative act with respect to the 2006 Transaction. Indeed, the Complaint states that "Grunstein and Forman undertook all the actions described [] regarding the transfers of the assets of THI and THMI." As such, for the Complaint to have stated a claim against Schron for alter-ego liability, 8 aiding and abetting breach of fiduciary duty, 9 and fraudulent conveyance 10 in connection with the 2006 Transaction, it must have alleged that Grunstein and Forman were acting as Schron's agents. The bankruptcy court concluded that the Complaint *1342 failed to properly allege such an agency relationship: "The Plaintiffs, however, fail to sufficiently allege the facts necessary to impute any knowledge by Forman and Grunstein to Schron or to bind him by their acts for purposes of their alter ego and aiding and abetting claims."

We agree. The Estates baldly claim that Grunstein and Forman exercised rights belonging to Schron "as Schron's agent, lawyer and fiduciary" in planning and executing the 2006 Transaction, but they fail to allege that Schron acknowledged, accepted, or instructed the two men to move forward with the Transaction—nor do they make the necessary connections to demonstrate how Schron stood to gain from the Transaction. That is, while Grunstein and Forman may have sometimes functioned as Schron's agent, lawyer, or fiduciary in other contexts, the Complaint does not allege that they operated in this capacity for purposes of the 2006 Transaction.

First, and importantly, the allegations do not plausibly establish that Schron ever held an ownership interest in THI, THMI, FLTCI, or FLTCH. And to suffice,

a factual allegation must do more than speculate that a right to relief might exist. It must "state a claim to relief that is plausible on its face." See Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007). The Complaint falls short of this standard. It states in pertinent part: "Grunstein informed Schron about FLTCH taking over the operations of [THI]," and Grunstein and Forman ultimately "agreed to give Schron an option to buy one-third of FLTCH for a nominal amount, so that Schron also benefitted from the transaction." An option agreement was subsequently executed among FLTCH. Forman, Grunstein, and "Schron's entity." (Emphasis added). It is not clear which "entity" this latter allegation refers to, though the Complaint later implies that Quality Health Services LLC ("QHS") was the recipient of the option. Yet, even stretching an implication into an allegation, the Complaint offers no explanation as to how, exactly, QHS was "Schron's entity." The Estates argue that the use of this possessive descriptor clearly alleged ownership, but there is no specific allegation regarding Schron's ownership of QHS, nor is there any allegation that Schron knew that "his entity" was purchasing such an option. Elsewhere in the complaint, the Estates allege that "FLTCH is owned by Forman and Grunstein," with no mention of any one-third interest held by "Schron's entity." Clearly, these allegations are insufficient to identify Schron as having any interest in these entities. And it is important to remember that these allegations were not made at a point in the litigation when Plaintiffs lacked the necessary knowledge to fill in the blanks. Plaintiffs had enjoyed the opportunity for extensive discovery in state-court proceedings by the time of the Second Amended Complaint.

In another attempt to find some way to place Schron in the Transaction, the Complaint identifies another entity, SWC Property Holdings, LLC ("SWC"), as "Schron's entity" and then alleges that SWC played a role in "forcing" the sale of THMI. Even if it had coherently explained SWC's involvement in the Transaction, the Complaint still fails to specify the nature of Schron's interest in or control over SWC during the relevant timeframe. ¹¹

The Complaint also alleges plainly contradictory facts regarding the fiduciary relationship *1343 between Schron, on the one hand, and Grunstein and Forman on the other. Oddly, the Complaint directly incorporates

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several factual allegations that were contained in a separate lawsuit Schron had filed against Grunstein and Forman, in which Schron alleged that Grunstein and Forman had executed the 2006 Transaction "surreptitiously," without his knowledge or involvement, and for their own benefit, in breach of duties they owed to him. Plaintiffs appear to think these allegations to be an admission by Schron that the two men functioned as his agents. But, to the contrary, Schron's Complaint alleged that the two men had failed to act as his agent in the 2006 Transaction. As the bankruptcy court noted, this is a problematic inconsistency because, at best, Plaintiffs offer only a conclusory assertion that Grunstein and Forman were acting on Schron's behalf, which they then directly contradict by specific allegations from Shron's incorporated complaint that assert quite the opposite. The Estates had no obligation to allege or incorporate facts from Schron's lawsuit against Forman and Grunstein. That they did so and included allegations that directly contradict the central premise of their claim -that Grunstein and Forman were acting on Schron's behalf—is, to say the least, not helpful.

Upon careful review of the pleadings, we agree with the bankruptcy court that the Complaint's allegations are too vague and inconsistent to successfully state a claim against Schron under an agency theory of liability. The failure to properly allege an agency relationship dooms the Estates' claims for alter-ego liability, aiding and abetting breach of fiduciary duty, and fraudulent conveyance with respect to the 2006 Transaction. We therefore AFFIRM the bankruptcy court's dismissal of these claims.

2. Claims Arising from 2012 Settlement Agreement

[20] The Estates also seek to revive a separate fraudulent-conveyance claim against Schron involving a 2012 transaction in which Schron was a direct participant. In January 2012, the THI receiver entered into an agreement with several of the Defendants—including Schron—whereby the receiver assigned to these defendants all claims the THI estate held against any third parties (the "2012 Settlement Agreement"). In exchange, these defendants collectively paid the receiver \$700,000. Schron personally supplied \$200,000 of the purchase price.

*1344 According to the Second Amended Complaint, these claims included "any and all claims that THI has

or may have against Schron," "THI's rights under the attorney-client privilege and the work-product doctrine," and a legal malpractice claim against the lawyers that represented THI and THMI in the wrongful-death cases that resulted in the empty-chair judgments. The Estates maintain that these claims—and the malpractice claim in particular—have a "potential value" of "well over \$2 billion." The Complaint specifically alleged that, because the wrongful-death judgments totaled \$1 billion and had been accruing interest over a number of years, the potential malpractice claim alone could, "[w]ithout a doubt," be worth more than \$2 billion. 12 The purported discrepancy between the supposed value of these claims and the \$700,000 purchase price—coupled with the fact that THI was insolvent at the time of the Agreement allegedly rendered the transfer fraudulent under various state laws.

[21] To state a plausible fraudulent-conveyance claim with respect to the 2012 Settlement Agreement, the Estates were required to allege facts demonstrating that the claims Schron received were not reasonably equivalent in value to the price he paid. "Reasonably equivalent value" does not mean dollar-for-dollar equivalence. See Crumpton v. Stephens (In re Northlake Foods, Inc.), 715 F.3d 1251, 1257 (11th Cir. 2013). Instead, courts make informed judgments as to asset valuation in light of the totality of the circumstances. Thus, in order to have "nudged their claims across the line from conceivable to plausible," Twombly, 550 U.S. at 570, 127 S.Ct. 1955, the Estates must have offered more than a bald assertion that the malpractice claim (in addition to the other unidentified claims Schron acquired) had, as alleged, a potential value of more than \$2 billion, or at the least that the value exceeded \$700,000.

We agree with both lower courts that the Second Amended Complaint failed to allege that, under the circumstances present at the time, \$700,000 was not a reasonably equivalent value for the transferred claims. While the Complaint does allege that a successful malpractice claim is theoretically worth at least the value of the underlying judgment, it does not address the potential costs of pursuing those claims, the likelihood that the underlying judgments might be reversed on appeal, or—most importantly—the probability of the claim succeeding. In fact, the Complaint does not set out any facts tending to show that the claims were worth upwards of \$1 billion, actually or in theory.

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For instance, in at least two portions of the Complaint, the Estates note that certain of the wrongful-death judgments against THI and THMI were subject to appeal in state and federal court. Such allegations introduce the possibility that a portion of the underlying emptychair judgments may be reversed. A reversal of those underlying judgments would, in turn, directly diminish the value of the malpractice claim. Thus, under the allegations of *1345 the Complaint itself, the expected value of that claim cannot be 100% of its potential value. The Complaint fails to acknowledge the connection between the alleged appeals and its valuation of the malpractice claim, and accordingly, it fails to discount the potential value of the malpractice claim by the probability that those reversals will succeed. The \$2 billion valuation is necessarily an overstatement.

More problematically, the Estates fail to address a glaring inconsistency between their valuation of the malpractice claim and their broader fraud argument. In order to succeed, the action for legal malpractice would require Schron to step into the shoes of the THI receiver and establish that THI's attorneys negligently failed to prevent the \$1 billion in empty-chair judgments against THI. This theory of liability arguably has some initial facial appeal, given the allegation that THI's defense counsel ultimately withdrew its representation of THI in those actions. But elsewhere in the Complaint, the Estates assert that THI's defense counsel withdrew its representation only at the express instruction of the THI receiver—who was, in turn, acting at the behest of Schron and the other Defendants—in furtherance of a common scheme to conceal the 2006 Transaction from creditors. Thus, under the Estates' description of the circumstances, establishing a viable malpractice claim would require a court to find THI's counsel liable to the THI receiver (and, derivatively, to Schron) for its obedience to the receiver's direct instructions. The chances of success on such a theory are clearly slim. And as the bankruptcy court observed, this conceptual inconsistency is plain from the face of the Second Amended Complaint.

Thus, the allegations contained in the Second Amended Complaint do not plausibly assert that the malpractice claim is worth the full value of the underlying empty-chair judgments (plus interest), as the Complaint supposes. Such a valuation would require an assumption that the malpractice claim has a near-absolute certain chance

of succeeding. The Complaint's own allegations make such an assumption implausible. In the absence of any countervailing allegations to overcome these issues and shore up the \$2 billion valuation, the Complaint does not state a claim that \$700,000 was less than reasonably equivalent value for the claims under the circumstances. ¹³

For these reasons, we conclude that the Second Amended Complaint does not contain sufficient factual detail to plausibly assert that the malpractice claim, or any of the other unidentified claims transferred through the 2012 Settlement Agreement, were sold for less than reasonably equivalent value. We therefore AFFIRM the bankruptcy court's dismissal of the fraudulent-conveyance claim arising from the 2012 Settlement Agreement.

3. Abuse of Process and Conspiracy to Commit Abuse of Process

[22] Finally, the Estates argue that their abuse-of-process claims against *1346 Schron were improperly dismissed. The Estates allege that Schron and the other defendants committed an abuse of process by asserting unauthorized defenses on behalf of THMI in order to advance their own interests. These claims relate to the 2012 Settlement Agreement between the Defendants and the THI receiver, discussed supra. In addition to assigning THI's claims against third parties to the Defendants, the 2012 Agreement purported to settle all claims that THI might have had against each of the Defendants. It also purported to assign to the Defendants the right to defend THMI in state-court proceedings against THMI brought by the Estates. After the 2012 Settlement Agreement was executed, the Defendants took control of the defense of THMI in state court.

[23] [24] Under Florida law, which governs this claim, "[a]buse of process involves the use of criminal or civil legal process against another primarily to accomplish a purpose for which it was not designed." See Bothmann v. Harrington, 458 So.2d 1163, 1169 (Fla. 3d DCA 1984). An abuse of process has not occurred unless the process is used to accomplish an immediate purpose other than that for which it was designed. Id. The fact that a party may be motivated by incidental or concurrent benefits of the use of process is not sufficient to constitute an abuse. See S & I Investments v. Payless Flea Mkt., Inc., 36 So.3d 909, 917 (Fla. 4th DCA 2010) ("There is no abuse of process ...

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when the process is used to accomplish the result for which it was created, regardless of an incidental or concurrent motive of spite or ulterior purpose." (emphasis in original) (quoting Bothmann, 458 So.2d at 1169)).

As both lower courts noted, the 2012 Settlement Agreement was likely unenforceable, and Defendants' conduct in subsequent state-court proceedings was improper. Indeed, the parties do not dispute that Defendants' counsel's representation of THMI pursuant to the 2012 Settlement Agreement was unauthorized and that Defendants misled various state courts with respect to the nature of THMI's defense. ¹⁴ But the question before us is not whether Defendants properly exercised their rights under the Agreement or whether the Agreement itself was enforceable as a matter of law. The sole question is whether the Complaint alleged that the Defendants' defense of THMI under the Agreement constituted a use of civil process that was intended to achieve an immediate purpose for which it was not designed. See Bothmann, 458 So.2d at 1169.

Thus, to plausibly state a claim for abuse of process, the Complaint must have alleged that the defense of THMI was not primarily designed for the simple goal of *1347 defending THMI. We agree with the bankruptcy court that the Complaint failed to so allege. While Schron and the other Defendants may have hoped that the defense of THMI would serve their own, separate interests, the only immediate impact of that defense in the state-court actions was to defend THMI. This is precisely the result for which such process was created. The fact that a successful defense of THMI would yield incidental benefits to Schron and other Defendants does not convert their unauthorized defense of THMI into an abuse of process under Florida law. All that the Complaint alleges is that the Defendants asserted a defense on THMI's behalf. This is not, by itself, sufficient to allege an abuse of process. 15

[25] For the above reasons, we AFFIRM the bankruptcy court's dismissal of claims of abuse of process and conspiracy to commit abuse of process against Schron. Because we find that the Complaint fails to allege the facts necessary to support these claims, we do not consider the alternative grounds on which the bankruptcy court dismissed them. ¹⁶

[26] [27] The bankruptcy court dismissed each of the claims against Schron with prejudice. Such dismissal is reviewed for abuse of discretion, and a court generally does not abuse its discretion where future amendments would be futile or unfairly prejudicial. We find no abuse of discretion.

The Estates' First Amended Complaint spanned nearly three-hundred pages and contained hundreds of repetitive paragraphs. Its narrative was convoluted and difficult to track. It did not comport with Rule 8's mandate to present a "short and plain statement of the claim." Fed. R. Civ. P. 8(a)(2) ("A pleading that states a claim for relief must contain: ... a short and plain statement of the claim showing that the pleader is entitled to relief."). The bankruptcy court nonetheless granted the Estates an opportunity to amend, acknowledging the complexity of the underlying transaction.

Instead of clarifying the content of the initial pleading and remedying its deficiencies *1348 of form, the allegations in the Estates' Second Amended Complaint were no clearer or more precise than those contained in the First Amended Complaint. The Second Amended Complaint not only failed to remedy the inadequacies the bankruptcy court had identified, but it also repeated, by incorporation, numerous paragraphs contained in the First Amended Complaint and added another sixty pages of allegations, including four entirely new claims against several of the Defendants. In addition to the counts already contained in the initial complaint, the Second Amended Complaint newly alleged that various defendants committed abuse of process, conspiracy to commit abuse of process, and negligence, in addition to executing an avoidable post-petition transfer under a separate section of the Bankruptcy Code. And in support of the claims that the Estates had already articulated, the Estates simply restated their initial factual allegations rather than adding new facts to illuminate Schron's role in the 2006 Transaction.

The Estates have given no indication that a third pleading would be any more fruitful than their second. If the Estates could have alleged viable claims against Schron, they already would have done so. We find no abuse of discretion in the court's decision not to grant the Estates a third bite at the apple and AFFIRM accordingly.

B. Dismissal with Prejudice

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CONCLUSION

We conclude that the bankruptcy court had jurisdiction to enjoin future claims arising from the 2006 Transaction and that it acted within the scope of its authority under the All Writs Act and the Anti-Injunction Act in issuing the Permanent Injunction. The Permanent Injunction was broad, but its breadth was justified in this case. We also find the various claims against Schron implausible as alleged in the Second Amended Complaint, even taking all the Estates' allegations as true. And given the Estates'

inability or unwillingness to remedy the deficiencies in their pleadings, the bankruptcy court exercised proper discretion in dismissing the Second Amended Complaint with prejudice. We therefore AFFIRM the bankruptcy court's dismissal of claims against Schron with prejudice and its issuance of a permanent injunction with respect to claims against Schron.

All Citations

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Footnotes

- * The Honorable C. Roger Vinson, Senior United States District Judge for the Northern District of Florida, sitting by designation.
- While the factual and procedural background of this case is complex, the scope of the appeal before us is relatively narrow. As such, we paint in broad strokes. For a detailed narrative of the underlying sequence of events, see *Estate of Jackson v. Gen. Elec. Capital Corp. (In re Fundamental Long Term Care, Inc.)*, 507 B.R. 359, 365–71 (Bankr. M.D. Fla. 2014).
- FLTCI's sole shareholder was an individual named Barry Saacks. Mr. Saacks is an elderly former graphic artist who currently lives in a nursing home. In the adversary proceeding, Plaintiffs alleged that Grunstein deceived Saacks by placing FLTCI in Saacks's name without his knowing involvement. In fact, it was later shown that Saacks had put forward no money to effectuate the transaction. He was an owner in name only.
- 3 This included the following claims against Schron:
 - (1) A common-law claim for aiding and abetting breach of fiduciary duties owed to THMI and THMI's creditors;
 - (2) Claims for a declaratory judgment establishing that Schron is liable as a successor to THI, THMI, and FLTCI and under veil-piercing and alter-ego theories;
 - (3) A claim for actual and constructive fraudulent transfers, as well as conspiracy to commit fraudulent transfers, under various state laws;
 - (4) A claim for abuse of process and conspiracy to commit abuse of process under Florida state law;
 - (5) A claim for negligence under Florida state law; and
 - (6) A claim to avoid certain postpetition transfers under the Bankruptcy Code.
- This statute permits a judgment creditor to seek avoidance of any transfers "made or contrived by the judgment debtor to delay, hinder, or defraud creditors." Fla. Stat. § 56.29(3)(b).
- According to the Estates, a "real party in interest" action would involve the Estates moving under Florida civil-procedural rules to add Schron as the "real defendant" in the earlier liability proceedings against THI and/or THMI on grounds that Schron was "materially interested in the subject matter of [the] suit" because he contributed to the payment of attorneys' fees in defense of those entities.
- Section 1983 provides: "Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State ... subjects, or causes to be subjected, any citizen of the United States ... to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured." The Estates' theory of § 1983 liability is unclear.
- 7 The bankruptcy court explained the scenario as follows:
 - The fact that the assets that were allegedly transferred to Schron ... belonged to THMI is crucial. If that is the case, what difference does it make if the creditors are going after those assets in an attempt to collect on a judgment against THI? How can the [Estates] collect on [their] judgment against THI by seeking to undo a transfer of assets that belong to THMI —whether under an alter ego or fraudulent transfer theory—without interfering with the administration of this estate?
- The Complaint alleged that FLTCH, Grunstein, Forman, and Schron were alter egos of FLTCI, the debtor, and that they were therefore derivatively liable for FLTCI's debts.
- The Complaint alleged that various entities involved in the 2006 Transaction breached fiduciary duties owed to THMI's creditors and that Grunstein, Forman, and Schron aided and abetted those breaches.

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- The Estates sought to avoid the transfer of assets to FLTCH through the 2006 Transaction under a theory of fraudulent conveyance. To establish liability for a fraudulent transfer under the Bankruptcy Code and the Uniform Fraudulent Transfer Act (which the relevant states have adopted), a plaintiff must show that property was transferred by the defendant for less than reasonably equivalent value at a time when the transferor was insolvent or in a manner that left the transferor insolvent. See 11 U.S.C. § 548(a)(B); see also Fla. Stat. § 726.105(1)(b). In this case, the debtor, FLTCI, was the immediate transferor but was allegedly controlled by its alter egos Grunstein and Forman. The Estates alleged that Grunstein and Forman were, in turn, acting as agents of Schron.
- The bankruptcy court characterized the Complaint's allegations regarding QHS and SWC as follows:

 As best the Court can tell, the Plaintiffs allege that one of three different people or entities actually own the one-third option [in FLTCH that the Estates claim is Schron's]. In one instance, the Plaintiffs allege that "[Grunstein] and Forman agreed to give Schron an option to buy one-third of FLTCH for a nominal amount," although they do not allege they actually gave Schron himself the option. In other instances, the Plaintiffs allege that "Schron's entity"—SWC Property Holdings, LLC—received the option, without alleging whether Schron has any ownership interest in that entity. If that is not confusing enough, the Plaintiffs allege in still other places that "Schron's entity"—presumably SWC Property Holdings—designated Quality Health Services, LLC to take title to the option. Again, there is no allegation regarding Schron's ownership interest—if any—in Quality Health Services. Trying to harmonize those seemingly contradictory allegations, it appears the Plaintiffs are alleging that Schron benefitted from the March 2006 transaction because Forman and Grunstein contracted with SWC Property Holdings to convey a one-third option to Quality Health Services.
- The Second Amended Complaint explained:

 Damages in a legal malpractice action are the amount of damages sustained by the client as [a] result of malpractice.

 As of the date of this filing, the THI Enterprise has sustained damages in the amount of \$1.4 billion, plus accruing interest. Three of the Plaintiffs['] Estates here still have pending litigation against the THI Enterprise. Without a doubt, the potential value of the THI Enterprise's claims could be well over \$2 billion.

Plaintiffs cannot plausibly state a claim that Schron personally benefitted from the March 2006 transaction.

Without any allegation that Schron actually owns SWC Property Holdings or Quality Health Services, however, the

- As the bankruptcy court put it, the Estates' valuation fails to consider, among other things, that the more than \$1 billion in judgments largely consist of punitive damages claims; all but one of those judgments is currently on appeal; and Schron's ability to prevail on the potential malpractice claims—which are based on the allegation that the lawyers for THI and THMI negligently withdrew their defenses of those entities in the state-court wrongful death cases—is seriously diminished because the lawyers took their direction from the THI Receiver (and Schron would be standing in the shoes of the THI Receiver pursuing the malpractice claims).
- There were two major problems with the 2012 Settlement Agreement and with the representation that followed. First, the agreement was between the Defendants and the THI receiver. But at that point in time, THI did not have an obligation or a right to indemnify or otherwise represent THMI in litigation filed against it. In effect, then, the Agreement purported to sell Defendants a right that THI did not actually possess. As a result, none of the Defendants was authorized at any time to fund or direct the legal defense of THMI. And yet that is precisely what they did. Second, when Defendants took over the defense of THMI, they misrepresented to the courts and to the Estates that they had "a duty to indemnify and a right to defend" THMI when, in fact, they did not. According to the Second Amended Complaint, counsel representing THMI also failed to disclose that it simultaneously represented the Defendants and was, therefore, "protecting and serving the Defendants" rather than or in addition to THMI.
- 15 As the bankruptcy court noted,
 - It would be one thing if the Plaintiffs were alleging an abuse of process claim based on FAS allegedly orchestrating a defense on THMI's behalf before THMI's counsel withdrew in 2010. At least there, the Plaintiffs would have a plausible claim that FAS (or some of the other Defendants) were not using their defense of THMI to avoid liability but rather to stall the litigation long enough for the statute of limitations to run on any fraudulent transfer claim arising out of the March 2006 transaction. That would arguably be an improper purpose. But asserting a defense on THMI's behalf for the purpose of avoiding liability—which is all that is alleged here—cannot give rise to an abuse of process claim.
- The bankruptcy court also concluded that the abuse-of-process claims were due to be dismissed under Florida law's litigation privilege, which affords immunity to allegedly tortious acts occurring during the course of a legal proceeding so long as they have some relation to the legal proceeding. See Levin, Middlebrooks, Mabie, Thomas, Mayes & Mitchell, P.A. v. U.S. Fire Ins. Co., 639 So.2d 606, 608 (Fla. 1994). The only way the Estates could escape the application of the litigation privilege was by proving that the defense of THMI was a "sham"—i.e., that the proceeding was "objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits." Atico Int'l USA, Inc. v.

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LUV N' Care, Ltd., No. 09-60397-CIV, 2009 WL 2589148, at *3 (S.D. Fla. Aug. 19, 2009). The bankruptcy court concluded that the Defendants' efforts to defend THMI were not a sham, as it was not unreasonable for them to believe they had authority to represent THMI based on the 2012 Settlement Agreement, even if the Agreement was later found to be unenforceable. We do not reach this issue.

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194 L.Ed.2d 655, 84 USLW 4270, 75 Collier Bankr.Cas.2d 943, 62 Bankr.Ct.Dec. 156...

KeyCite Yellow Flag - Negative Treatment
Declined to Extend by In re Lopez-Munoz, 1st Cir., August 9, 2017
136 S.Ct. 1581
Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC., petitioner

v. Daniel Lee RITZ, Jr.

No. 15–145. | Argued March 1, 2016. | Decided May 16, 2016.

Synopsis

Background: Creditor, a seller of electronic device components, brought adversary proceeding against Chapter 7 debtor, the individual who was in financial control of the company that had purchased components from creditor, seeking to pierce corporate veil in order to hold debtor personally liable on corporate debt, and to except debt from discharge on, inter alia, a "false pretenses, false representation, or actual fraud" theory. Following trial, the United States Bankruptcy Court for the Southern District of Texas, Jeff Bohm, J., 459 B.R. 623, entered judgment in favor of debtor, and creditor appealed. The District Court, Melinda Harmon, J., 513 B.R. 510, affirmed. Creditor appealed. The Court of Appeals for the Fifth Circuit, Carolyn Dineen King, Circuit Judge, 787 F.3d 312, affirmed. Certiorari was granted.

[Holding:] The Supreme Court, Justice Sotomayor, held that the term "actual fraud," as used in the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation.

Reversed and remanded.

Justice Thomas filed a dissenting opinion.

West Headnotes (22)

[1] Bankruptcy

Actual, constructive, or implied fraud

Term "actual fraud," as used in the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation. 11 U.S.C.A. § 523(a)(2)(A).

85 Cases that cite this headnote

[2] Statutes

Presumptions

When Congress acts to amend a statute, courts presume it intends its amendment to have real and substantial effect.

1 Cases that cite this headnote

[3] Bankruptcy



Supreme Court has historically construed the terms in the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud to contain the elements that the common law has defined them to include. 11 U.S.C.A. § 523(a)(2)(A).

16 Cases that cite this headnote

[4] Fraud

Intent

Word "actual" has a simple meaning in the context of common-law fraud, denoting any fraud that involves moral turpitude or intentional wrong.

13 Cases that cite this headnote

[5] Fraud

Intent

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In the context of common-law fraud, "actual" fraud stands in contrast to "implied fraud" or "fraud in law," which describe acts of deception that may exist without the imputation of bad faith or immorality.

23 Cases that cite this headnote

[6] Fraud

Intent

In the context of common-law fraud, anything that counts as "fraud" and is done with wrongful intent is "actual fraud."

32 Cases that cite this headnote

[7] Fraud

Nature of fraud

Common-law "fraud" connotes deception or trickery generally.

8 Cases that cite this headnote

[8] Fraudulent Conveyances

Mature of fraud in transfers of property

Common-law term "actual fraud" is broad enough to incorporate a fraudulent conveyance.

5 Cases that cite this headnote

[9] Fraudulent Conveyances

Elements of Fraud as to Creditors

Common-law fraudulent conveyances, although a "fraud," do not require a misrepresentation from a debtor to a creditor.

2 Cases that cite this headnote

[10] Fraudulent Conveyances

Particular facts and circumstances

Common-law fraudulent conveyances are not an inducement-based fraud, but typically involve a transfer to a close relative, a secret transfer, a transfer of title without transfer of possession, or grossly inadequate consideration.

4 Cases that cite this headnote

[11] Fraudulent Conveyances

Effect of transaction to delay, hinder, or defraud

In the context of common-law fraudulent conveyances, the fraudulent conduct is not in dishonestly inducing a creditor to extend a debt but, rather, is in the acts of concealment and hindrance.

3 Cases that cite this headnote

[12] Fraudulent Conveyances

Effect of transaction to delay, hinder, or defraud

Fraudulent Conveyances

Nature and Adequacy

Fraudulent Conveyances

Effect of Good Faith of Grantee

Conveyance which hinders, delays, or defrauds creditors shall be void as against the recipient unless that party received it in good faith and for consideration.

1 Cases that cite this headnote

[13] Bankruptcy

Fraud

Bankruptcy

Fraud

Fiduciary who engages in a fraudulent conveyance may find his debt exempted from discharge under either the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, or the discharge exception for fiduciary fraud. 11 U.S.C.A. §§ 523(a)(2)(A), (a)(4).

31 Cases that cite this headnote

[14] Bankruptcy

Fraud

Bankruptcy

In general; fraud

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Debtors who commit fraudulent conveyances and debtors who make false representations under the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud could also inflict "willful and malicious injury" under the discharge exception for debts for willful and malicious injury. 11 U.S.C.A. § 523(a)(2)(A), (a)(6).

7 Cases that cite this headnote

[15] Bankruptcy

Fraud

Bankruptcy

Fraud

Discharge exception for fiduciary fraud covers only debts for fraud while acting as a fiduciary, whereas the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud has no similar limitation. 11 U.S.C.A. § 523(a)(2)(A), (a)(4).

2 Cases that cite this headnote

[16] Bankruptcy

Fraud

Bankruptcy

Willful or Malicious Injury

Discharge exception for debts for willful and malicious injury covers debts "for willful and malicious injury," whether or not that injury is the result of fraud, whereas the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud covers only fraudulent acts. 11 U.S.C.A. § 523(a)(2)(A), 523(a)(6).

1 Cases that cite this headnote

[17] Bankruptcy

Fraudulent or Preferential Transfer

Bankruptcy

Concealment of Property

Bankruptcy

Fraud

Section of the Bankruptcy Code providing for denial of a Chapter 7 debtor's discharge for having fraudulently transferred or concealed property is broader in scope than the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, with the former preventing an offending debtor from discharging all debt in bankruptcy. 11 U.S.C.A. § 523(a)(2)(A), 727(a)(2).

Cases that cite this headnote

[18] Bankruptcy

Fraudulent or Preferential Transfer

Bankruptcy

Concealment of Property

Bankruptcy

Fraud

Section of the Bankruptcy Code providing for denial of a Chapter 7 debtor's discharge for having fraudulently transferred or concealed property is narrower in timing than the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, applying only if the debtor fraudulently conveys assets in the year preceding the bankruptcy filing. 11 U.S.C.A. § 523(a)(2)(A), 727(a)(2).

1 Cases that cite this headnote

[19] Bankruptcy

Fraudulent or Preferential Transfer

Bankruptcy

Concealment of Property

Bankruptcy

Fraud

While the section of the Bankruptcy Code providing for denial of a Chapter 7 debtor's discharge for having fraudulently transferred or concealed property is a blunt remedy for actions that hinder the entire bankruptcy process, the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud is a tailored remedy for behavior connected to specific debts. 11 U.S.C.A. § 523(a)(2)(A), 727(a)(2).

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8 Cases that cite this headnote

[20] Bankruptcy

Obtaining money, property, or service

Recipient of a fraudulent transfer, who, with the requisite intent, commits fraud, can "obtain" assets "by" his or her participation in the fraud, within the meaning of the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud. 11 U.S.C.A. § 523(a)(2)(A).

12 Cases that cite this headnote

[21] Bankruptcy

Fraud

Bankruptcy

Intent or knowledge

If the recipient of a fraudulent conveyance who obtains the transfer with the requisite fraudulent intent later files for bankruptcy, any debts "traceable to" the fraudulent conveyance will be nondischargeable under the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud. 11 U.S.C.A. § 523(a)(2)(A).

14 Cases that cite this headnote

[22] Bankruptcy

Fraud

Bankruptcy

Extension of credit

Under the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, there is no requirement that the relevant debts result from fraud at the inception of a credit transaction. 11 U.S.C.A. § 523(a)(2)(A).

28 Cases that cite this headnote

*1583 Syllabus

Chrysalis Manufacturing Corp. incurred a debt to petitioner Husky International Electronics, Inc., of nearly \$164,000. Respondent Daniel Lee Ritz, Jr., Chrysalis' director and part owner at the time, drained Chrysalis of assets available to pay the debt by transferring large sums of money to other entities Ritz controlled. Husky sued Ritz to recover on the debt. Ritz then filed for Chapter 7 bankruptcy, prompting Husky to file a complaint in Ritz' bankruptcy case, seeking to hold him personally liable and contending that the debt was not dischargeable because Ritz' intercompany-transfer scheme constituted "actual fraud" under the Bankruptcy Code's discharge exceptions. 11 U.S.C. § 523(a)(2)(A).

The District Court held that Ritz was personally liable under state law but also held that the debt was not "obtained by ... actual fraud" under § 523(a)(2)(A) and thus could be discharged in bankruptcy. The Fifth Circuit affirmed, holding that a misrepresentation from a debtor to a creditor is a necessary element of "actual fraud" and was lacking in this case, because Ritz made no false representations to Husky regarding the transfer of Chrysalis' assets.

Held: The term "actual fraud" in § 523(a)(2)(A) encompasses fraudulent conveyance schemes, even when those schemes do not involve a false representation. Pp. 1586 – 1590.

*1584 (a) It is sensible to presume that when Congress amended the Bankruptcy Code in 1978 and added to debts obtained by "false pretenses or false representations" an additional bankruptcy discharge exception for debts obtained by "actual fraud," it did not intend the term "actual fraud" to mean the same thing as the alreadyexisting term "false representations." See United States v. Quality Stores, Inc., 572 U.S. —, 134 S.Ct. 1395, 188 L.Ed.2d 413. Even stronger evidence that "actual fraud" encompasses the kind of conduct alleged to have occurred here is found in the phrase's historical meaning. At common law, "actual fraud" meant fraud committed with wrongful intent, Neal v. Clark, 95 U.S. 704, 709, 24 L.Ed. 586. And the term "fraud" has, since the beginnings of bankruptcy practice, been used to describe asset transfers that, like Ritz' scheme, impair a creditor's ability to collect a debt.

One of the first bankruptcy Acts, the Fraudulent Conveyances Act of 1571, 13 Eliz., ch. 5, identified

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as "fraud" conveyances made with "[i]ntent to delay hynder or defraude [c]reditors." The degree to which that statute remains embedded in fraud-related laws today, see, *e.g., BFP v. Resolution Trust Corporation,* 511 U.S. 531, 540, 114 S.Ct. 1757, 128 L.Ed.2d 556, clarifies that the common-law term "actual fraud" is broad enough to incorporate fraudulent conveyances. The common law also indicates that fraudulent conveyances do not require a misrepresentation from a debtor to a creditor, see *id.*, at 541, 114 S.Ct. 1757 as they lie not in dishonestly inducing a creditor to extend a debt but in the acts of concealment and hindrance. Pp. 1586 – 1588.

(b) Interpreting "actual fraud" in § 523(a)(2)(A) to encompass fraudulent conveyances would not, as Ritz contends, render duplicative two of § 523's other discharge exceptions, §§ 523(a)(4), (6), given that "actual fraud" captures much conduct not covered by those other provisions. Nor does this interpretation create a redundancy in § 727(a)(2), which is meaningfully different from § 523(a)(2)(A). It is also not incompatible with § 523(a)(2)(A)'s "obtained by" requirement. Even though the transferor of a fraudulent conveyance does not obtain assets or debts through the fraudulent conveyance, the transferee—who, with the requisite intent, also commits fraud-does. At minimum, those debts would not be dischargeable under § 523(a)(2)(A). Finally, reading the phrase "actual fraud" to restrict, rather than expand, the discharge exception's reach would untenably require reading the disjunctive "or" in the phrase "false pretenses, a false representation, or actual fraud" to mean "by." Pp. 1588 - 1590.

787 F.3d 312, reversed and remanded.

SOTOMAYOR, J., delivered the opinion of the Court, in which ROBERTS, C.J., and KENNEDY, GINSBURG, BREYER, ALITO, and KAGAN, JJ., joined. THOMAS, J., filed a dissenting opinion.

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Opinion

Justice SOTOMAYOR delivered the opinion of the Court.

The Bankruptcy Code prohibits debtors from discharging debts "obtained by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2) (A). The Fifth Circuit held that a debt is "obtained by ... actual fraud" only if the debtor's fraud involves a false representation to a creditor. That ruling deepened an existing split among the Circuits over whether "actual fraud" requires a false representation or whether it encompasses other traditional forms of fraud that can be accomplished without a false representation, such as a fraudulent conveyance of property made to evade payment to creditors. We granted certiorari to resolve that split and now reverse.

Ι

Husky International Electronics, Inc., is a Colorado-based supplier of components used in electronic devices. Between 2003 and 2007, Husky sold its products to Chrysalis Manufacturing Corp., and Chrysalis incurred a debt to Husky of \$163,999.38. During the same period, respondent Daniel Lee Ritz, Jr., served as a director of Chrysalis and owned at least 30% of Chrysalis' common stock.

All parties agree that between 2006 and 2007, Ritz drained Chrysalis of assets it could have used to pay its debts to creditors like Husky by transferring large sums of Chrysalis' funds to other entities Ritz controlled. For instance—and Ritz' actions were by no means limited to these examples—Ritz transferred \$52,600 to CapNet Risk Management, Inc., a company he owned in full; \$121,831 to CapNet Securities Corp., a company in which

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he owned an 85% interest; and \$99,386.90 to Dynalyst Manufacturing Corp., a company in which he owned a 25% interest.

In May 2009, Husky filed a lawsuit against Ritz seeking to hold him personally responsible for Chrysalis' \$163,999.38 debt. Husky argued that Ritz' intercompany-transfer scheme was "actual fraud" for purposes of a Texas law that allows creditors to hold shareholders responsible for corporate debt. See Tex. Bus. Orgs. Code Ann. § 21.223(b) (West 2012). In December 2009, Ritz filed for Chapter 7 bankruptcy in the United States Bankruptcy Court for the Southern District of Texas. Husky then initiated an adversarial proceeding in Ritz' bankruptcy case again seeking to hold Ritz personally liable for Chrysalis' debt. Husky also contended that Ritz could not discharge that debt in bankruptcy because the same intercompany-transfer scheme constituted "actual fraud" under 11 U.S.C. § 523(a)(2)(A)'s exemption to discharge. 1

The District Court held that Ritz was personally liable for the debt under Texas law, but that the debt was not "obtained by ... actual fraud" under § 523(a)(2)(A) and could be discharged in his bankruptcy.

The Fifth Circuit affirmed. It did not address whether Ritz was responsible for Chrysalis' debt under Texas law because it agreed with the District Court that Ritz *1586 did not commit "actual fraud" under § 523(a) (2)(A). Before the Fifth Circuit, Husky argued that Ritz' asset-transfer scheme was effectuated through a series of fraudulent conveyances—or transfers intended to obstruct the collection of debt. And, Husky said, such transfers are a recognizable form of "actual fraud." The Fifth Circuit disagreed, holding that a necessary element of "actual fraud" is a misrepresentation from the debtor to the creditor, as when a person applying for credit adds an extra zero to her income or falsifies her employment history. In re Ritz, 787 F.3d 312, 316 (2015). In transferring Chrysalis' assets, Ritz may have hindered Husky's ability to recover its debt, but the Fifth Circuit found that he did not make any false representations to Husky regarding those assets or the transfers and therefore did not commit "actual fraud."

[1] We reverse. The term "actual fraud" in § 523(a) (2)(A) encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation.

II

Α

Before 1978, the Bankruptcy Code prohibited debtors from discharging debts obtained by "false pretenses or false representations." § 35(a)(2) (1976 ed.). In the Bankruptcy Reform Act of 1978, Congress added "actual fraud" to that list. 92 Stat. 2590. The prohibition now reads: "A discharge under [Chapters 7, 11, 12, or 13] of this title does not discharge an individual debtor from any debt ... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud." § 523(a)(2)(A) (2012 ed.).

[2] When "'Congress acts to amend a statute, we presume it intends its amendment to have real and substantial effect." *United States v. Quality Stores, Inc.,* 572 U.S. —, —, 134 S.Ct. 1395, 1401, 188 L.Ed.2d 413 (2014). It is therefore sensible to start with the presumption that Congress did not intend "actual fraud" to mean the same thing as "a false representation," as the Fifth Circuit's holding suggests. But the historical meaning of "actual fraud" provides even stronger evidence that the phrase has long encompassed the kind of conduct alleged to have occurred here: a transfer scheme designed to hinder the collection of debt.

[3] [4] [5] [6] This Court has historically construed the terms in § 523(a)(2)(A) to contain the "elements that the common law has defined them to include." *Field v. Mans*, 516 U.S. 59, 69, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). "Actual fraud" has two parts: actual and fraud. The word "actual" has a simple meaning in the context of common-law fraud: It denotes any fraud that "involv[es] moral turpitude or intentional wrong." *Neal v. Clark*, 95 U.S. 704, 709, 24 L.Ed. 586 (1878). "Actual" fraud stands in contrast to "implied" fraud or fraud "in law," which describe acts of deception that "may exist without the imputation of bad faith or immorality." *Ibid.* Thus, anything that counts as "fraud" and is done with wrongful intent is "actual fraud."

[7] Although "fraud" connotes deception or trickery generally, the term is difficult to define more precisely. See 1 J. Story, Commentaries on Equity Jurisprudence

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§ 189, p. 221 (6th ed. 1853) (Story) ("Fraud ... being so various in its nature, and so extensive in its application to human concerns, it would be difficult to enumerate all the instances in which Courts of *1587 Equity will grant relief under this head"). There is no need to adopt a definition for all times and all circumstances here because, from the beginning of English bankruptcy practice, courts and legislatures have used the term "fraud" to describe a debtor's transfer of assets that, like Ritz' scheme, impairs a creditor's ability to collect the debt.

[8] One of the first bankruptcy acts, the Statute of 13 Elizabeth, has long been relied upon as a restatement of the law of so-called fraudulent conveyances (also known as "fraudulent transfers" or "fraudulent alienations"). See generally G. Glenn, The Law of Fraudulent Conveyances 89–92 (1931). That statute, also called the Fraudulent Conveyances Act of 1571, identified as fraud "faigned covenous and fraudulent Feoffmentes Gyftes Grauntes Alienations [and] Conveyaunces" made with "Intent to delaye hynder or defraude Creditors." 13 Eliz. ch. 5. In modern terms, Parliament made it fraudulent to hide assets from creditors by giving them to one's family, friends, or associates. The principles of the Statute of 13 Elizabeth—and even some of its language—continue to be in wide use today. See BFP v. Resolution Trust Corporation, 511 U.S. 531, 540, 114 S.Ct. 1757, 128 L.Ed.2d 556 (1994) ("The modern law of fraudulent transfers had its origin in the Statute of 13 Elizabeth"); id., at 541, 114 S.Ct. 1757 ("Every American bankruptcy law has incorporated a fraudulent transfer provision"); Story § 353, at 393 ("[T]he statute of 13 Elizabeth ... has been universally adopted in America, as the basis of our jurisprudence on the same subject"); Boston Trading Group, Inc. v. Burnazos, 835 F.2d 1504, 1505-1506 (C.A.1 1987) (Breyer, J.) ("Mass. Gen. Laws ch. 109A, §§ 1-13 ... is a uniform state law that codifies both common and statutory law stretching back at least to 1571 and the Statute of Elizabeth"). The degree to which this statute remains embedded in laws related to fraud today clarifies that the common-law term "actual fraud" is broad enough to incorporate a fraudulent conveyance.

[9] [10] [11] Equally important, the common law also indicates that fraudulent conveyances, although a "fraud," do not require a misrepresentation from a debtor to a creditor. As a basic point, fraudulent conveyances are not an inducement-based fraud. Fraudulent conveyances typically involve "a transfer to a close relative, a secret

transfer, a transfer of title without transfer of possession, or grossly inadequate consideration." BFP, 511 U.S., at 540-541, 114 S.Ct. 1757 (citing Twyne's Case, 3 Co. Rep. 80b, 76 Eng. Rep. 809 (K.B. 1601)); O. Bump, Fraudulent Conveyances: A Treatise Upon Conveyances Made by Debtors To Defraud Creditors 31-60 (3d ed. 1882). In such cases, the fraudulent conduct is not in dishonestly inducing a creditor to extend a debt. It is in the acts of concealment and hindrance. In the fraudulentconveyance context, therefore, the opportunities for a false representation from the debtor to the creditor are limited. The debtor may have the opportunity to put forward a false representation if the creditor inquires into the whereabouts of the debtor's assets, but that could hardly be considered a defining feature of this kind of fraud.

[12] Relatedly, under the Statute of 13 Elizabeth and the laws that followed, both the debtor and the recipient of the conveyed assets were liable for fraud even though the recipient of a fraudulent conveyance of course made no representation, true or false, to the debtor's creditor. The famous Twyne's Case, which this Court relied upon in BFP, illustrates this point. See Twyne's Case, 76 Eng. Rep., at 823 (convicting Twyne of fraud under the Statute of 13 Elizabeth, even though he was *1588 the recipient of a debtor's conveyance). That principle underlies the now-common understanding that a "conveyance which hinders, delays or defrauds creditors shall be void as against [the recipient] unless ... th[at] party ... received it in good faith and for consideration." Glenn, Law of Fraudulent Conveyances § 233, at 312. That principle also underscores the point that a false representation has never been a required element of "actual fraud," and we decline to adopt it as one today.

В

Ritz concedes that fraudulent conveyances are a form of "actual fraud," ² but contends that 11 U.S.C. § 523(a)(2) (A)'s particular use of the phrase means something else. Ritz' strained reading of the provision finds little support.

First, Ritz contends that interpreting "actual fraud" in § 523(a)(2)(A) to encompass fraudulent conveyances would render duplicative two other exceptions to discharge in § 523. Section 523(a)(4) exempts from discharge "any debt ... for fraud or defalcation while acting in a fiduciary

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capacity, embezzlement, or larceny." And § 523(a)(6) exempts "any debt ... for willful and malicious injury by the debtor to another entity or to the property of another entity."

[14] Ritz makes the unremarkable point that the traditional definition of "actual fraud" will cover some of the same conduct as those exceptions: for example, a trustee who fraudulently conveys away his trust's assets. But Ritz' interpretation does not avoid duplication, nor does our interpretation fail to preserve a meaningful difference between § 523(a)(2)(A) and §§ 523(a)(4), (6). Just as a fiduciary who engages in a fraudulent conveyance may find his debt exempted from discharge under either § 523(a)(2)(A) or § 523(a)(4), so too would a fiduciary who engages in one of the fraudulent misrepresentations that form the core of Ritz' preferred interpretation of § 523(a)(2)(A). The same is true for § 523(a)(6). The debtors who commit fraudulent conveyances and the debtors who make false representations under § 523(a)(2)(A) could likewise also inflict "willful and malicious injury" under § 523(a)(6). There is, in short, overlap, but that overlap appears inevitable.

[15] [16] And, of course, our interpretation of "actual fraud" in § 523(a)(2)(A) also preserves meaningful distinctions between that provision and §§ 523(a)(4), (a) (6). Section 523(a)(4), for instance, covers only debts for fraud while acting as a fiduciary, whereas § 523(a)(2)(A) has no similar limitation. Nothing in our interpretation alters that distinction. And § 523(a)(6) covers debts "for willful and malicious injury," whether or not that injury is the result of fraud, see *Kawaauhau v. Geiger*, 523 U.S. 57, 61, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998) (discussing injuries resulting from "intentional torts'"), whereas § 523(a)(2)(A) covers only fraudulent acts. Nothing in our interpretation alters that distinction either. Thus, given the clear differences between these provisions, we see no reason to craft an artificial definition of "actual fraud" merely to avoid narrow redundancies in § 523 that appear unavoidable.

[17]creates redundancy with a separate section of the Bankruptcy Code, § 727(a)(2), which prevents a debtor from discharging all of his debts if, within the *1589 year preceding the bankruptcy petition, he "transferred, removed, destroyed, mutilated, or concealed" property "with intent to hinder, delay, or defraud a creditor or an

officer of the estate charged with custody of property." Although the two provisions could cover some of the same conduct, they are meaningfully different. Section 727(a) (2) is broader than § 523(a)(2)(A) in scope—preventing an offending debtor from discharging all debt in bankruptcy. But it is narrower than $\S 523(a)(2)(A)$ in timing—applying only if the debtor fraudulently conveys assets in the year preceding the bankruptcy filing. In short, while § 727(a) (2) is a blunt remedy for actions that hinder the entire bankruptcy process, § 523(a)(2)(A) is a tailored remedy for behavior connected to specific debts.

Ritz' next point of resistance rests on § 523(a)(2)(A)'s requirement that the relevant debt be "for money, property, services, or ... credit ... obtained by ... actual fraud." (Emphasis added.) The argument, which the dissent also emphasizes, has two parts: First, it posits that fraudulent conveyances (unlike other forms of actual fraud) cannot be used to "obtai[n]" debt because they function instead to hide valuables that a debtor already possesses. Brief for Respondent 20, 31. There is, the dissent says, no debt at the end of a fraudulent conveyance that could be said to "'resul[t] from' " or be "'traceable to' " the fraud. Post, at 1591 (quoting Field, 516 U.S., at 61, 64, 116 S.Ct. 437). Second, it urges that "actual fraud" not be interpreted to encompass forms of fraud that are incompatible with the provision's "obtained by" requirement.

[21] It is of course true that the transferor does not "obtai [n]" debts in a fraudulent conveyance. But the recipient of the transfer—who, with the requisite intent, also commits fraud—can "obtai[n]" assets "by" his or her participation in the fraud. See, e.g., McClellan v. Cantrell, 217 F.3d 890 (C.A.7 2000); see also supra, at 1587 – 1588. If that recipient later files for bankruptcy, any debts "traceable to" the fraudulent conveyance, see Field, 516 U.S., at 61, 116 S.Ct. 437; post, at 1591, will be nondischargable under § 523(a)(2)(A). Thus, at least sometimes a debt "obtained by" a fraudulent conveyance scheme could be nondischargeable under § 523(a)(2)(A). Such circumstances may be rare because a person who [18] Ritz also says that our interpretation receives fraudulently conveyed assets is not necessarily (or even likely to be) a debtor on the verge of bankruptcy, ³ but they make clear that fraudulent conveyances are not wholly incompatible with the "obtained by" requirement.

> [22] The dissent presses further still, contending that the phrase "obtained by ... actual fraud" requires not only

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that the relevant debts "resul [t] from" or be "traceable to" fraud but also that they "result from fraud at the inception of a credit transaction." Post, at 1591 (emphasis added). Nothing in the text of § 523(a)(2)(A) supports that additional requirement. The dissent bases its conclusion on this Court's opinion in Field, in which the Court noted that certain forms of bankruptcy fraud require a degree of direct reliance by a creditor on an action taken by a debtor. But Field discussed such "reliance" only in setting forth the requirements of the form of fraud alleged in that case—namely, fraud perpetrated through a misrepresentation to a creditor. *1590 See 516 U.S., at 61, 116 S.Ct. 437. The Court was not establishing a "reliance" requirement for frauds that are not premised on such a misrepresentation.

Finally, Ritz argues that Congress added the phrase "actual fraud" to § 523(a)(2)(A) not to expand the exception's reach, but to restrict it. In Ritz' view, "actual fraud" was inserted as the last item in a disjunctive list—"false pretenses, a false representation, or actual fraud"—in order to make clear that the "false pretenses" and "false representation[s]" covered by the provision needed to be intentional. Brief for Respondent 29–31. Ritz asks us, in other words, to ignore what he believes is Congress' "imprudent use of the word 'or,' " id., at 32, and read the final item in the list to modify and limit the others. In essence, he asks us to change the word "or" to "by." That is an argument that defeats itself. We can think of no other example, nor could petitioner point to any at oral argument, in which this Court has attempted such an unusual statutory modification.

* * *

Because we must give the phrase "actual fraud" in § 523(a)(2)(A) the meaning it has long held, we interpret "actual fraud" to encompass fraudulent conveyance schemes, even when those schemes do not involve a false representation. We therefore reverse the judgment of the Fifth Circuit and remand the case for further proceedings consistent with this opinion.

So ordered.

Justice THOMAS, dissenting.

The Bankruptcy Code exempts from discharge "any debt ... for money, property, [or] services ... to the extent

obtained by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A) (emphasis added). The Court holds that "actual fraud" encompasses fraudulent transfer schemes effectuated without any false representation to a creditor and concludes that a debt for goods may "sometimes" be "obtained by" a fraudulent transfer scheme. Ante, at 1585 – 1586, 1589. Because § 523(a)(2)(A) does not apply so expansively, I respectfully dissent.

Ι

In my view, "actual fraud" within the meaning of § 523(a) (2) does not encompass fraudulent transfer schemes. There are two types of fraudulent transfer schemes: "transfers made with actual intent to hinder, delay, or defraud creditors, referred to as actual fraudulent transfers" and "transfers made for less than reasonably equivalent value when a debtor was in financial trouble, [which is] referred to as constructive fraudulent transfers." 2 Bankruptcy Law Manual § 9A:29, p. 333 (5th ed. 2015). I do not quibble with the majority's conclusion that the common-law definition of "actual fraud" included fraudulent transfers. Ante, at 1586 - 1588. And I agree that, generally, we should give a common-law term of art its established common-law meaning. Ante, at 1586. Nevertheless, the "general rule that a common-law term of art should be given its established common-law meaning" gives way "where that meaning does not fit." United States v. Castleman, 572 U.S. —, —, 134 S.Ct. 1405, 1410, 188 L.Ed.2d 426 (2014) (internal quotation marks omitted). Ultimately, "[s]tatutory language must be read in context and a phrase gathers meaning from the words around it." Jones v. United States, 527 U.S. 373, 389, 119 S.Ct. 2090, 144 L.Ed.2d 370 (1999) (internal quotation marks omitted). In my view, context dictates that "actual fraud" ordinarily does not include fraudulent transfers because "that meaning does not fit" with the rest of § 523(a)(2). Castleman, *1591 supra, at ——, 134 S.Ct., at 1410 (internal quotation marks omitted).

Section 523(a)(2) covers only situations in which "money, property, [or] services" are "obtained by ... actual fraud," and results in a debt. See *Cohen v. de la Cruz*, 523 U.S. 213, 218, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998). The statutory phrase "obtained by" is an important limitation on the reach of the provision. Section 523(a)(2)(A) applies only when the fraudulent conduct occurs at the *inception*

Husky Intern. Electronics, Inc. v. Ritz, 136 S.Ct. 1581 (2016)

194 L.Ed.2d 655, 84 USLW 4270, 75 Collier Bankr.Cas.2d 943, 62 Bankr.Ct.Dec. 156...

of the debt, i.e., when the debtor commits a fraudulent act to induce the creditor to part with his money, property, services, or credit. The logical conclusion then is that "actual fraud"—as it is used in the statute—covers only those situations in which some sort of fraudulent conduct caused the creditor to enter into a transaction with the debtor. A fraudulent transfer generally does not fit that mold, unless, perhaps, the fraudulent transferor and the fraudulent transferee conspired to fraudulently drain the assets of the creditor. But the fraudulent transfer here, like all but the rarest fraudulent transfers, did not trick the creditor into selling his goods to the buyer, Chrysalis Manufacturing Corporation. It follows that the goods that resulted in the debt here were not "obtained by" actual fraud. § 523(a)(2)(A).

A

I reach this conclusion based on the plain meaning of the phrase "obtained by," which has an "inherent" "element of causation," and refers to those debts "resulting from" or "traceable to" fraud. Field v. Mans, 516 U.S. 59, 61, 64, 66, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). As I have stated, "in order for a creditor to establish that a debt is not dischargeable, he must demonstrate that there is a causal nexus between the fraud and the debt." Archer v. Warner, 538 U.S. 314, 325, 123 S.Ct. 1462, 155 L.Ed.2d 454 (2003) (THOMAS, J., dissenting) (relying on *Field, supra*, at 61, 64, 116 S.Ct. 437 and Cohen, supra, at 218, 118 S.Ct. 1212). There is also "[n]o ... doub[t] that some degree of reliance is required to satisfy th[is] element of causation." Field, 516 U.S., at 66, 116 S.Ct. 437. The upshot of the phrase "obtained by" is that § 523(a)(2) covers only those debts that result from fraud at the inception of a credit transaction. Such a debt caused by fraud necessarily "follows a transfer of value or extension of credit induced by falsity or fraud." Ibid. (emphasis added).

Bankruptcy treatises confirm that "[t]he phrase 'to the extent obtained by' is properly read as meaning 'obtained from' the creditor." 3 W. Norton & W. Norton, Bankruptcy Law and Practice § 57:15, p. 57–35 (3d ed. 2015). The "term 'by' refers to the manner in which such money, property, services is obtained and the creditor defrauded." *Ibid.* According to Collier on Bankruptcy, to invoke § 523(a)(2)(A) based on "actual fraud," a creditor "must establish" that he "justifiably relied" on the debtor's "representation," which the debtor "knew to be false"

and made "with the intent and purpose of deceiving the" creditor and that the creditor "sustained a loss or damage as the proximate consequence." 4 Collier on Bankruptcy ¶ 523.08[1][e], p. 523–47 (A. Resnick & H. Sommer eds., 16th ed. 2015). Norton Bankruptcy Law and Practice is in accord: Section 523(a)(2)(A) requires a "misrepresentation," "knowledge of falsity," "intent to defraud," "justifiable reliance," and "resulting damage." 3 Norton, *supra*, § 57:15, at 57–33 to 57–34.

В

Applying those principles here, Husky cannot invoke § 523(a)(2)(A) to except the debt owed to it from discharge because, ordinarily, it would be nonsensical to say *1592 that a fraudulent transfer created the debt at issue. As the majority notes, the debt at issue did not originate from any transaction between Ritz and Husky. Ante, at 1585. Instead, Husky sold goods to Chrysalis, a company that Ritz financially controlled. Ibid. In turn, Chrysalis—not Ritz-incurred a debt to Husky of \$163,999.38 for the goods. Ante, at 1585. As the Bankruptcy Court found, there is no evidence that Ritz made "any oral or written representations to Husky inducing Husky to enter into a contract with Chrysalis." In re Ritz, 459 B.R. 623, 628 (S.D.Tex.2011). In fact, the only communication between Ritz and Husky occurred after Husky and Chrysalis entered into the contract and after Husky had shipped the goods to Chrysalis. Ibid. The Bankruptcy Court also found that there was no evidence that Ritz transferred the funds to avoid Chrysalis' obligations to pay the debt it owed to Husky—an unsecured creditor. Id., at 635. Because Husky does not contend that Ritz fraudulently induced it to sell goods to Chrysalis and cannot show that the constructive fraudulent conveyance had anything to do with its decision to contract with Chrysalis, Husky has not established that § 523(a)(2)(a) covers any debt owed to it.

II

The majority reaches the opposite conclusion and holds that § 523(a)(2) may prevent an individual debtor from obtaining a discharge even if (1) the debtor makes no false representation to the creditor, (2) the creditor does not rely on any of the debtor's actions or inactions, and (3) there was no actual fraudulent conveyance at the

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inception of the credit transaction between the creditor and the debtor. *Ante*, at 1587 – 1588, 1589. It does so by giving new meaning to the phrase "obtained by" in cases involving fraudulent transfers, disregarding our case law, and second-guessing Congress' choices. *Ante*, at 1589.

The majority admits that a transferor "does not 'obtai[n]' debts in a fraudulent conveyance," but contends that "the recipient of the transfer—who, with the requisite intent, also commits fraud—can 'obtain' assets 'by' his or her participation in the fraud." Ibid. (brackets omitted). "If that recipient later files for bankruptcy, any debts traceable to the fraudulent conveyance," the majority states, "will be nondischargable under § 523(a)(2)(A)." Ibid. (internal quotation marks omitted). The majority thus holds that "at least sometimes a debt 'obtained by' a fraudulent conveyance scheme could be nondischargeable under § 523(a)(2)(A)." Ibid. But § 523(a)(2)(A) does not exempt from discharge any debts "traceable to the fraudulent conveyance." Instead, § 523(a)(2)(A) exempts from discharge "any debt for" goods that are "obtained by" actual fraud. And, as explained, it is extremely rare that a creditor will use an actual fraudulent transfer scheme to induce a creditor to depart with property, services, money, or credit. See *supra*, at 1590 – 1591.

In reaching its conclusion, the majority also disregards this Court's precedents interpreting § 523(a)(2)(A), presumably because those cases did not involve fraudulent transfers. The majority cites *Field* only for the elemental proposition that this Court "has historically construed the terms in § 523(a)(2)(A) to contain the 'elements that the common law has defined them to include." Ante, at 1586 (quoting 516 U.S., at 69, 116 S.Ct. 437). The majority omits Field 's conclusion that one of the elements of "actual fraud" in § 523(a)(2)(A) is "reliance" on some sort of false statement, misrepresentation, or omission. *Id.*, at 70, 116 S.Ct. 437 (emphasis added). To be sure, like the rest of our cases interpreting § 523(a)(2)(A), Field involves *1593 a false statement. But that factual distinction is immaterial. Cases like Field—which interpret the phrase "obtained by"—are as relevant in cases that involve false statements and misrepresentations as they are in a case like this one. After all, "obtained by" modifies false pretenses, false representations, and actual fraud in § 523(a)(2)(A). And in no case has this Court suggested—never mind held—that § 523(a)(2)(A) may apply to circumstances in which there was no false statement, misrepresentation, or omission when the debt was first obtained.

The majority ostensibly creates a new definition of "obtained by" because it thinks that this move is necessary to avoid rendering "actual fraud" superfluous. See ante, at 1586, 1588 - 1589. Not so. Actual fraud is broader than false pretenses or false representations, and "consists of any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another." 4 Collier on Bankruptcy ¶ 523.08 [1][e], at 523–46. "Unlike false pretenses or false representation, actual fraud, within the meaning of the dischargeability exception, can focus on a promise of future performance made with intent not to perform." 2F Bankruptcy Service § 27:211, p. 59 (Supp. Jan. 2016). In this way, "the actual fraud" exception "permit[s] the courts to except from discharge debts incurred without intent to repay, or by use of other false implied representations, without the need to stretch the false pretenses and false representations language." Zaretsky, The Fraud Exception to Discharge Under the New Bankruptcy Code, 53 Am. Bankruptcy L.J. 253, 257 (1979). Some courts, for example, have held that "a debtor commits actual fraud within the meaning of § 523(a)(2)(A) when he incurs credit card debt with no actual, subjective intent to repay it," but has not made an affirmatively false representation or engaged in false pretense. *In re Morrow*, 488 B.R. 471, 479–480 (Bkrtcy.Ct.N.D.Ga.2012); see also, e.g., In re Alam, 314 B.R. 834, 841 (Bkrtcy.Ct.N.D.Ga.2004). Defining actual fraud this way does not render that term superfluous and—unlike the majority's definition—does not render "obtained by" a nullity.

Regardless, even if there is some overlap between the definitions of "false pretenses," "false representations," and "actual fraud," "[r]edundancies across statutes are not unusual events in drafting." Connecticut Nat. Bank v. Germain, 503 U.S. 249, 253, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992). "[T]he canon against surplusage assists only where a competing interpretation gives effect to every clause and word of a statute." Marx v. General Revenue Corp., 568 U.S. —, —, 133 S.Ct. 1166, 1177, 185 L.Ed.2d 242 (2013) (internal quotation marks omitted). "But, in this case, no interpretation of [§ 523(a) (2)(A)] gives effect to every word." *Ibid.* Under either my reading or the majority's reading, "actual fraud" is broader than and subsumes "false pretenses" and "false representations." Accordingly, that "actual fraud" may introduce some redundancy in the statute is not dispositive.

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At bottom, the majority's attempt to broaden § 523(a)(2) (A) to cover fraudulent transfers impermissibly secondguesses Congress' choices. When Congress wants to stop a debtor from discharging a debt that he has concealed through a fraudulent transfer scheme, it ordinarily says so. See § 727(a)(2) (stating that a court shall grant the debtor a discharge unless the debtor engages in an actual fraudulent transfer scheme within a certain time of filing a bankruptcy petition). If Congress wanted § 523(a)(2) (A) to cover fraudulent transfer situations, "it would have spoken more clearly to that effect." *1594 Staples v. United States, 511 U.S. 600, 620, 114 S.Ct. 1793, 128 L.Ed.2d 608 (1994). Ultimately, "it is not for us to substitute our view of policy for the legislation which has been passed by Congress." Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc., 554 U.S. 33, 52, 128 S.Ct. 2326,

171 L.Ed.2d 203 (2008) (ellipsis and internal quotation marks omitted).

* * *

The majority today departs from the plain language of § 523(a)(2)(A), as interpreted by our precedents. Because I find no support for the Court's conclusion in the text of the Bankruptcy Code, I respectfully dissent.

All Citations

136 S.Ct. 1581, 194 L.Ed.2d 655, 84 USLW 4270, 75 Collier Bankr.Cas.2d 943, 62 Bankr.Ct.Dec. 156, Bankr. L. Rep. P 82,943, 14 Cal. Daily Op. Serv. 5016, 2016 Daily Journal D.A.R. 4574, 26 Fla. L. Weekly Fed. S 135

Footnotes

- * The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.
- Husky also alleged that Ritz' debt should be exempted from discharge under two other exceptions, see 11 U.S.C. § 523(a)(4) (excepting debts for fraud "while acting in a fiduciary capacity"); § 523(a)(6) (excepting debts for "willful and malicious injury"), but does not press those claims in this petition.
- See Tr. of Oral Arg. 30 (Justice KAGAN: "[Y]ou're not contesting that fraudulent conveyance is a form of actual fraud; is that right?" Ms. Murphy: "[Y]es, that's right"); *id.*, at 27 (Ms. Murphy: "[T]o be clear, we don't dispute that fraudulent conveyance is a form of actual fraud").
- Ritz' situation may be unusual in this regard because Husky contends that Ritz was both the transferor and the transferee in his fraudulent conveyance scheme, having transferred Chrysalis assets to other companies he controlled. We take no position on that contention here and leave it to the Fifth Circuit to decide on remand whether the debt to Husky was "obtained by" Ritz' asset-transfer scheme.

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Matter of Birenbaum, 691 Fed.Appx. 155 (2017)

691 Fed.Appx. 155
This case was not selected for publication in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1 generally governing citation of judicial decisions issued on or after Jan. 1, 2007. See also
U.S.Ct. of App. 5th Cir. Rules 28.7 and 47.5.
United States Court of Appeals,
Fifth Circuit.

In the MATTER OF: Dennis H. BIRENBAUM, Debtor Brian O'Grady, M.D.; The O'Grady Family Partnership, Limited, Appellants

Dennis Birenbaum, M.D., Appellee

No. 16-11512 | Filed June 20, 2017

Synopsis

Background: Creditor brought adversary proceeding against Chapter 7 debtor, seeking a determination that the \$1,150,000 owed to him was excepted from discharge. The bankruptcy court overruled creditor's objection to discharge. The United States District Court for the Northern District of Texas affirmed. Creditor appealed.

[Holding:] The Court of Appeals held that debt arising from art purchase agreement did not fall within fraud discharge exception.

Affirmed.

West Headnotes (1)

[1] Bankruptcy

Intent or knowledge

Debt arising from art purchase agreement, whereby creditor agreed to pay \$1 million to Chapter 7 debtor, an oncologist, and the cancer center that debtor owned and operated in exchange for option to purchase certain

art owned by debtor for additional \$150,000 or to receive his \$1 million back along with an additional \$150,000, did not fall within fraud discharge exception; ultimately, creditor declined to purchase the art and requested his \$1 million back plus the additional \$150,000, and creditor obtained state court injunctions against debtor and cancer center from selling any of the art, but while the state court case was pending, debtor filed for bankruptcy protection, and debtor denied any fraud. 11 U.S.C.A. § 523(a)(2).

Cases that cite this headnote

*156 Appeal from the United States District Court for the Northern District of Texas, USDC No. 3:15-CV-1898

Attorneys and Law Firms

Sheldon Edward Richie, Katherine Jane Walters, Richie & Gueringer, P.C., Austin, TX, for Appellants

John Paul Lewis, Jr., Esq., Dallas, TX, for Appellee

Before HIGGINBOTHAM, GRAVES, and HIGGINSON, Circuit Judges.

Opinion

PER CURIAM: *

This is a bankruptcy dispute between two doctors. Dr. Brian O'Grady, a neurosurgeon, lent \$1,000,000 to Dr. Dennis Birenbaum, an oncologist, without ever having met him. Dr. Birenbaum failed to repay, then filed for bankruptcy protection. Dr. O'Grady intervened in Dr. Birenbaum's bankruptcy proceeding and objected to the discharge of the \$1,000,000-plus debt owed to him, claiming that it was obtained by fraud and therefore exempt from discharge. After a three-day evidentiary hearing, the bankruptcy court disagreed and overruled Dr. O'Grady's objection to discharge. The district court summarily affirmed. We affirm as well.

Dr. Birenbaum founded, owns, and operates a Dallasarea cancer center called Texas Hematology/Oncology Center, P.A. ("THOC"). In 2006, THOC found itself in dire financial trouble, operating at a net loss and showing Matter of Birenbaum, 691 Fed.Appx. 155 (2017)

a stockholders' equity of negative \$6,500,000. In Dr. Birenbaum's words, THOC "desperately needed money." Dr. Birenbaum enlisted the help of a financial consultant named David Miller.

In early 2007, Miller approached Dr. O'Grady to seek his investment in THOC. Miller knew Dr. O'Grady, having previously advised Dr. O'Grady on financial matters. Dr. O'Grady had significant cash from the sale of his investment in a surgical center. Miller brought with him a package of information that he had compiled relating to THOC's finances. What documents were included and whether they painted an accurate financial picture of THOC are subject to dispute. Dr. O'Grady centers some of his fraud claims on alleged inaccuracies and omissions in this information.

After reviewing the information, Dr. O'Grady signed a contract presented to him by Miller called an "Art Purchase Agreement"—the peculiar instrument creating the debt at the heart of this dispute. Under the Art Purchase Agreement, Dr. O'Grady was immediately obligated to pay \$1,000,000 to Dr. Birenbaum and THOC. After 90 days, Dr. O'Grady would then have the option either (A) to purchase certain art owned by Dr. Birenbaum for an additional \$150,000, or (B) to receive his \$1,000,000 back along with an additional \$150,000. The Agreement calls the upfront \$1,000,000 "earnest money" and the \$150,000 additional return if Dr. O'Grady chose not to purchase the art "liquidated damages."

The Agreement contains a section titled "Representations and Warranties of Seller," stating that "Sellers represent and warrant that they own the Art free and clear of all debts and encumbrances, and that the security interest of Buyer will be a first lien position." It also states that "Buyer may fully rely upon the representations, warranties, and covenants made to Buyer in this Agreement and on the accuracy *157 of any document, certificate, or other instrument given or delivered to Buyer pursuant to this Agreement." Despite this representation, Dr. O'Grady offered evidence that the art in question was subject to a lien in favor of a company called Siemens Financial Services, Inc. ("Siemens") at the time of the Agreement.

On the same day, Dr. O'Grady also executed a "Security Agreement" that purported to create a lien in favor of Dr. O'Grady on all of Dr. Birenbaum's

"[a]rt, accounts, accounts receivable, equipment, general intangibles, goods, fixtures, health care insurance receivables, inventory, instruments, investment property, and the proceeds thereof." Dr. O'Grady never recorded or otherwise perfected this "lien." That Security Agreement included the provision that "Debtors agree not to ... [s]ell, transfer, or encumber any of the Collateral, except in the ordinary course of Debtor's business." Despite this representation, Dr. O'Grady offered evidence that Dr. Birenbaum was negotiating with a company called TAC to sell some of the artwork around the same time that Miller solicited Dr. O'Grady; that negotiation eventually resulted in a final sale of some of the art.

After Dr. O'Grady had executed the Art Purchase Agreement, a \$1,300,000 judgment was entered against Dr. Birenbaum in an unrelated contract action, and within a week of that judgment, that plaintiff applied for turnover of THOC stock. Dr. O'Grady now bases his fraud claim in part on Dr. Birenbaum's failure to disclose this fact to him.

Pursuant to the Agreement, Dr. O'Grady transferred \$1,000,000 to Dr. Birenbaum. Thereafter, to make an informed decision whether to exercise his option to buy the art, Dr. O'Grady looked up art valuation on the internet, called some storage facilities, spoke with his art collector friends, and spoke with the appraisers who had evaluated Dr. Birenbaum's art collection. Ultimately, he settled on declining the option to purchase the art and instead asked for his \$1,000,000 back (plus the additional \$150,000). Dr. Birenbaum and THOC have not paid any of the \$1,150,000 due to Dr. O'Grady under the Agreement. ¹

Dr. O'Grady sued Dr. Birenbaum and THOC in Texas state court and obtained injunctions against them from selling any of the art. However, while that state-court action was pending, Dr. Birenbaum filed for Chapter 7 bankruptcy protection—the case currently before the court. Dr. O'Grady intervened and filed a proof of unsecured claim with the bankruptcy court. He then filed an adversary complaint seeking a determination that the \$1,150,000 owed to him was excepted from discharge under 11 U.S.C. § 523(a)(2)(A) & (B), two provisions making nondischargeable debt resulting from fraud. Dr. Birenbaum denied any fraud.

After hearing the testimony of three witnesses—the doctors themselves and Dr. Birenbaum's accountant—over three days, the bankruptcy court found that neither

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exception applied to bar discharge. Dr. *158 O'Grady appealed to the district court, which summarily affirmed. He timely appealed to this court.

"Generally, a bankruptcy court's findings of fact are reviewed for clear error and conclusions of law are reviewed de novo." "However, for a 'mixed question of law and fact,' the 'factual premises' are reviewed for clear error but the ultimate 'legal conclusion' is reviewed de novo." 4

Upon careful review of the record, the findings of the bankruptcy court, the applicable law, and the arguments of the parties, we detect no clear error in the bankruptcy court's rejection of Dr. O'Grady's claims. For that reason, we affirm the judgment of the district court, which in turn affirmed the judgment of the bankruptcy court.

All Citations

691 Fed.Appx. 155

Footnotes

- * Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.
- Dr. O'Grady may have been partially compensated for this loss through settlements reached in other lawsuits against Dr. O'Grady's own financial advisor and Dr. Birenbaum's accountant. One of Dr. Birenbaum's arguments in the bankruptcy court was that these collateral sources of compensation offset any nondischargeable debt he owed. However, the bankruptcy court did not reach the issue, and neither do we.
- Previously, Dr. O'Grady had intervened in THOC's Chapter 11 bankruptcy proceeding and filed a proof of *secured* claim, but the bankruptcy court ruled that Dr. O'Grady did not possess a valid lien on the artwork. In the instant case, Dr. Birenbaum's personal bankruptcy, Dr. O'Grady recognizes that he is bound by that prior judgment and asserts only an unsecured claim.
- 3 In re Renaissance Hosp. Grand Prairie Inc., 713 F.3d 285, 294 (5th Cir. 2013) (quoting In re Gerhardt, 348 F.3d 89, 91 (5th Cir. 2003)).
- 4 Id. (quoting Whitehouse Hotel Ltd. P'ship v. C.I.R., 615 F.3d 321, 333 (5th Cir. 2010)).

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O'Grady v. Birenbaum, --- S.Ct. ---- (2017)

86 USLW 3212, 86 USLW 3215

2017 WL 4155712 Supreme Court of the United States

Brian O'GRADY, et al., petitioners,

Dennis BIRENBAUM.

No. 17–411. | Oct. 30, 2017. Case below, 691 Fed.Appx. 155.

Opinion

*1 Petition for writ of certiorari to the United States Court of Appeals for the Fifth Circuit denied.

All Citations

--- S.Ct. ----, 2017 WL 4155712 (Mem), 86 USLW 3212, 86 USLW 3215

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In re New Investments, Inc, 840 F.3d 1137 (2016)

76 Collier Bankr.Cas.2d 1191, 63 Bankr.Ct.Dec. 97, Bankr. L. Rep. P 83,029...

840 F.3d 1137 United States Court of Appeals, Ninth Circuit.

IN RE NEW INVESTMENTS, INC, Debtor.

Pacifica L 51 LLC, Creditor-Appellant,

v.

New Investments Inc., Debtor-Appellee.

No. 13-36194

Argued and Submitted May 3, 2016—Seattle, Washington

Filed November 4, 2016

Synopsis

Background: Deed of trust lender objected to confirmation of debtor's proposed Chapter 11 plan, which purported to cure debtor's default on deed of trust loan by making plan payments that included interest only at lower, predefault interest rate. The United States Bankruptcy Court for the Western District of Washington, Marc Barreca, J., overruled lender's objection and entered order confirming plan, and lender appealed.

[Holding:] The Court of Appeals, Murguia, Circuit Judge, held that, while debtor, by curing default on deed of trust loan, was entitled to return to pre-default conditions, debtor could cure its default only in accordance with terms of deed of trust loan agreement, which required payment of post-default interest at higher default rate in order to effect cure.

Reversed and remanded.

Berzon, Circuit Judge, filed dissenting opinion.

West Headnotes (11)

[1] Bankruptcy

Curing defaults

Provision of Chapter 11 indicating that plan of reorganization must provide adequate means for its implementation, including the "curing or waiving of any default," means that plan may include a provision authorizing debtor to remedy any breach of loan agreement and to return to pre-default conditions. 11 U.S.C.A. § 1123(a)(5)(G).

2 Cases that cite this headnote

[2] Bankruptcy

Conclusions of law; de novo review

On appeal, the Court of Appeals reviews bankruptcy court's interpretation of bankruptcy statutes de novo.

Cases that cite this headnote

[3] Statutes

Language

When construing statute, court begins with language of statute.

Cases that cite this headnote

[4] Statutes

In general; factors considered

Statutes

Plain, literal, or clear meaning; ambiguity

If statutory text is ambiguous, court may employ other tools, such as legislative history, to ascertain the meaning of ambiguous terms.

Cases that cite this headnote

[5] Statutes

Burden of proof

Party contending that legislative act changed settled law has burden of showing that the legislature intended such a change.

Cases that cite this headnote

[6] Bankruptcy

Curing defaults

While Chapter 11 debtor, by curing default on deed of trust loan, was entitled to return

In re New Investments, Inc, 840 F.3d 1137 (2016)

76 Collier Bankr.Cas.2d 1191, 63 Bankr.Ct.Dec. 97, Bankr. L. Rep. P 83,029...

to pre-default conditions, debtor could cure its default only in accordance with terms of deed of trust loan agreement and governing Washington law, a law which, because loan agreement required payment of post-default interest at higher default rate, mandated payment of interest by debtor at higher default rate in order to effect such a cure; merely by proposing to cure default in Chapter 11 plan, debtor did not become entitled to effect this cure, contrary to terms of loan agreement, by payments that included interest component calculated at pre-default rate. 11 U.S.C.A. § 1123(d); Wash. Rev. Code Ann. § 61.24.090(1) (a).

3 Cases that cite this headnote

[7] Statutes

Operation and Effect

Fact that Congress had a particular purpose in mind when enacting statute does not limit the effect of statute's text.

Cases that cite this headnote

[8] Statutes

Relation to plain, literal, or clear meaning; ambiguity

Fact that Congress may not have foreseen all of the consequences of statutory enactment is not a sufficient reason for refusing to give effect to statute's plain meaning.

Cases that cite this headnote

[9] Bankruptcy

Curing defaults

While Chapter 11 debtor, by curing default on mortgage loan by means of plan payments, can avoid acceleration or foreclosure, two of the more common consequences of default, debtor does not effectuate a cure merely by paying past due installments of principal at the pre-default interest rate; rather, debtor's "cure" obligations may also include late charges, attorneys' and trustee's fees, and

publication and court costs. 11 U.S.C.A. § 1123(d).

2 Cases that cite this headnote

[10] Bankruptcy

Protection Against Discrimination or Collection Efforts in General; 'Fresh Start.'

Principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor. 11 U.S.C.A. § 101 et seq.

Cases that cite this headnote

[11] Bankruptcy

in general;nature and purpose

Bankruptcy Code is not a purely remedial statute, and Chapter 11 strikes a balance between debtor's interest in reorganizing and restructuring its debts and creditors' interest in maximizing value of bankruptcy estate. 11 U.S.C.A. §§ 101 et seq., 1101 et seq.

Cases that cite this headnote

*1138 Appeal from the United States Bankruptcy Court for the Western District of Washington, Marc Barreca, Bankruptcy Judge, Presiding. D.C. No. 13–10948–MLB

Attorneys and Law Firms

Dillon E. Jackson (argued) and Terrance J. Keenan, Foster Pepper PLLC, Seattle, Washington; Stuart P. Kastner, Stuart P. Kastner PLLC, Seattle, Washington; for Creditor–Appellant.

Lawrence K. Engel (argued), Bellevue, Washington, for Debtor–Appellee.

Before: Susan P. Graber, Marsha S. Berzon, and Mary H. Murguia, Circuit Judges.

Dissent by Judge Berzon

OPINION

In re New Investments, Inc, 840 F.3d 1137 (2016)

76 Collier Bankr.Cas.2d 1191, 63 Bankr.Ct.Dec. 97, Bankr. L. Rep. P 83,029...

MURGUIA, Circuit Judge:

In loan agreements—and any subsequent bankruptcy proceedings—a borrower "defaults" on a loan when he fails to fulfill a material obligation under the terms of the loan agreement, such as making a payment by a particular date. A default can trigger certain consequences, such as foreclosure on any property securing the loan, late fees and penalties, or "acceleration," which occurs when the entire unpaid amount of the loan becomes immediately due and payable. But the borrower can also "cure" the default, most often by paying the arrearages and bringing the loan current. A cure generally allows the borrower to avoid the consequences of default, restores the loan to its original terms, and allows the borrower to keep the property.

[1] The Bankruptcy Code incorporates the concept of cure. Chapter 11 provides that a debtor's plan of reorganization must "provide adequate means for the plan's implementation," including the "curing or waiving of any default." *1139 11 U.S.C. § 1123(a)(5)(G). This statute means that a plan of reorganization may include a provision authorizing the debtor to remedy any breach of a loan agreement with a creditor and return to pre-default conditions. *Great W. Bank & Tr. v. Entz–White Lumber & Supply, Inc.* (In re Entz–White Lumber & Supply, Inc.), 850 F.2d 1338, 1340 (9th Cir. 1988).

We held in *Entz–White* that a debtor who cures a default—is entitled to avoid all consequences of the default—including higher post-default interest rates." *Id.* at 1342. In other words, if a loan agreement provided for a higher, post-default interest rate on arrearages in the event of default, a debtor who "cures" is entitled to repay the arrearages at the lower, pre-default interest rate. We concluded that "the power to cure under the Bankruptcy Code authorizes a plan to nullify all consequences of default, including avoidance of default penalties such as higher interest," even when the terms of the loan agreement called for a higher interest rate upon default. *Id.*

The case before us requires us to decide whether *Entz—White* 's rule that a debtor may nullify a loan agreement's requirement of post-default interest remains good law in light of 11 U.S.C. § 1123(d), a provision that Congress enacted after *Entz—White*. Section 1123(d) provides that, if a plan proposes to cure a default, "the amount necessary to cure the default shall be determined in accordance with

the underlying agreement and applicable nonbankruptcy law." 11 U.S.C. § 1123(d). We hold that *Entz–White* 's rule of allowing a curing debtor to avoid a contractual post-default interest rate in a loan agreement is no longer valid in light of § 1123(d).

I.

New Investments, Inc. ("New Investments") borrowed \$3,045,760.51 from Pacifica L 51, LLC's ("Pacifica") predecessor in interest to purchase a hotel property in Kirkland, Washington. The note, which was secured by a deed of trust, provided for an interest rate of 8 percent. The note also specifically provided that in the event of default, the interest rate would increase by 5 percent.

New Investments defaulted on the note in 2009. When Pacifica commenced non-judicial foreclosure proceedings, New Investments filed for Chapter 11 bankruptcy. New Investments's plan of reorganization proposed to cure the default by selling the property to a third party and using the proceeds of the sale to pay the outstanding amount of the loan at the pre-default interest rate. Pacifica objected to the plan on the ground that, under the terms of the note, it was entitled to be paid at the higher, *post-default* interest rate.

The bankruptcy court confirmed New Investments's plan over Pacifica's objection and authorized the sale of the hotel for \$6,890,000. Of the sale proceeds, \$2,830,877.28 would be paid to Pacifica, reflecting the *pre-default* interest rate and extinguishing any other late penalties. Anticipating an appeal, the bankruptcy court ordered that \$100,000 of the proceeds be reserved for Pacifica's attorney's fees on appeal and that \$670,000 be set aside as a disputed claim reserve for Pacifica. Pacifica timely appeals from the confirmation order.

II.

[2] [3] [4] [5] We have jurisdiction under 28 U.S.C. § 158(d), and we review the bankruptcy court's interpretation of bankruptcy statutes de novo. *Boyajian v. New Falls Corp. (In re Boyajian)*, 564 F.3d 1088, 1090 (9th Cir. 2009). "When construing the meaning of a statute, we begin with the language of that statute." *Benko v. Quality Loan Serv. Corp.*, 789 F.3d 1111, 1118 (9th Cir. 2015).

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"If the statutory text is ambiguous, *1140 we employ other tools, such as legislative history, to construe the meaning of ambiguous terms." *Id.* "A party contending that legislative action changed settled law has the burden of showing that the legislature intended such a change." *Green v. Bock Laundry Mach. Co.*, 490 U.S. 504, 521, 109 S.Ct. 1981, 104 L.Ed.2d 557 (1989).

III.

[6] Chapter 11 of the Bankruptcy Code provides that a plan of reorganization must, among other things, "provide adequate means for the plan's implementation," including the "curing or waiving of any default." 11 U.S.C. $\S 1123(a)(5)(G)$. In *Entz-White*, we observed that the Bankruptcy Code did not define "cure." 850 F.2d at 1340. We borrowed the Second Circuit's definition: "A default is an event in the debtor-creditor relationship which triggers certain consequences. Curing a default commonly means taking care of the triggering event and returning to pre-default conditions. The consequences are thus nullified. This is the concept of 'cure' used throughout the Bankruptcy Code." Id. (alteration omitted) (quoting Di Pierro v. Taddeo (In re Taddeo), 685 F.2d 24, 26-27 (2d Cir. 1982)). We held that "the power to cure under the Bankruptcy Code authorizes a plan to nullify all consequences of default, including avoidance of default penalties such as higher interest." Id. at 1342. As a result, a debtor whose plan proposed to cure a default would allow him to avoid having to pay a higher, post-default interest rate called for in the loan agreement.

Entz–White was decided in 1988. In 1994, Congress amended § 1123 to add subsection (d). Pub. L. No. 103–394, Title II, § 305, Oct. 22, 1994, 108 Stat. 4106. Subsection (d) provides:

Notwithstanding subsection (a) of this section and sections 506(b), 1129(a)(7), and 1129(b) of this title, if it is proposed in a plan to cure a default the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.

11 U.S.C. § 1123(d).

Subsection § 1123(d) renders void *Entz–White* 's rule that a debtor who proposes to cure a default may avoid a higher, post-default interest rate in a loan agreement. Subsection (d) governs here because New Investments's plan proposes to cure a default. The underlying agreement -here, the promissory note-requires the payment of a higher interest rate upon default. And "applicable nonbankruptcy law"-here, Washington state lawallows for a higher interest rate upon default when provided for in the loan agreement. See Wash. Rev. Code Ann. § 61.24.090(1)(a) (providing that a borrower may cure a monetary default by paying the trustee "[t]he entire amount then due under the terms of the deed of trust and the obligation secured thereby, other than such portion of the principal as would not then be due had no default occurred"). In other words, under § 1123(d), "the amount necessary to cure [New Investments's] default" is governed by the deed of trust and Washington law, which respectively require and permit repayment at a higher, post-default interest rate.

*1141 The plain language of § 1123(d) compels the holding that a debtor cannot nullify a preexisting obligation in a loan agreement to pay post-default interest solely by proposing a cure. But even if we were to read ambiguity into the statute, the legislative history would not help New Investments. The House Report for the bill that became § 1123(d) states that Congress was primarily concerned with overruling the Supreme Court's decision in Rake v. Wade, 508 U.S. 464, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993). H.R. Rep. No. 103-835, at *55 (1994). Rake had held that a Chapter 13 debtor who proposed to cure a default was required to pay interest on his arrearages to a secured creditor even if the underlying loan agreement did not provide for such interest. 508 U.S. at 472, 113 S.Ct. 2187. Congress viewed this as an untoward result that allowed for "interest on interest payments" and provided an unbargained-for windfall to creditors. H.R. Rep. No. 103-835, at *55. The House Report states that § 1123(d) would "limit the secured creditor to the benefit of the initial bargain with no court contrived windfall." Id. It further stated that it was "the Committee's intention that a cure pursuant to a plan should operate to put the debtor in the same position as if the default had never occurred." *Id.*

[7] [8] The fact that Congress had a particular purpose in mind when enacting a statute does not limit the effect of the statute's text, a principle *Entz–White* itself recognized. *See* 850 F.2d at 1341 (noting that a Senate Report for

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the bill that became 11 U.S.C. § 1124 showed "only that the drafters in the Senate were concerned primarily with defaults resulting in acceleration; it does not show that they meant to confine the section to that situation"). Rather, "[t]he fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning." *Union Bank v. Wolas*, 502 U.S. 151, 158, 112 S.Ct. 527, 116 L.Ed.2d 514 (1991). By its terms, § 1123(d) tells us to look to the promissory note and Washington law to determine what amount New Investments must pay to cure its default. Here, that analysis requires the payment of post-default interest.

This result is further consistent with the intent of § 1123(d) because it holds the parties to the benefit of their bargain. Moreover, the House Report's statement "that a cure pursuant to a plan should operate to put the debtor in the same position as if the default had never occurred" is consistent with the concept of cure generally, which § 1123(d) has not altered or attempted to define. *See Taddeo*, 685 F.2d at 26–27 ("Curing a default commonly means taking care of the triggering event and returning to pre-default conditions. The consequences are thus nullified.").

[9] What § 1123(d) affects is how a debtor returns to pre-default conditions, which can include returning to a lower, pre-default interest rate. In the traditional case, a borrower who has defaulted on a loan obligation can cure the default by paying arrearages. See Restatement (Third) of Property (Mortgages) § 8.1(b) & cmt. c (1997); Wash. Rev. Code Ann. § 61.24.090(a)(1). This procedure allows the borrower to avoid acceleration or foreclosure, which are some of the more common consequences of default. See Restatement (Third) of Property (Mortgages) § 8.1(a); Wash. Rev. Code Ann. § 61.24.090(a). However, the borrower does not effectuate a cure merely by paying past due installments of principal at the pre-default interest rate. Rather, the borrower's cure obligations may also include "late charges, attorneys' and trustee's fees, and publication and court costs." Restatement (Third) of *1142 Property (Mortgages) § 8.1 cmt. c; see also Wash. Rev. Code Ann. § 61.24.090(1)(b). It is only once these penalties are paid that the debtor can return to pre-default conditions as to the remainder of the loan obligation.

The common law treatment of cure is consistent with the Bankruptcy Code's protections for creditors who would have been entitled to receive accelerated payment on a defaulted loan. For a debtor to render such a creditor "unimpaired" and unable to object to the debtor's plan, *Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070, 1075 (9th Cir. 2002); 11 U.S.C. § 1126(f), the debtor must cure the default but may not "otherwise alter the legal, equitable, or contractual rights" of the creditor, 11 U.S.C. § 1124(2)(E). Here, one of those rights is post-default interest, and New Investments's cure may not alter that right.

Consistent with § 1124(2), the debtor can return to predefault conditions, which can include a lower, pre-default interest rate, only by fulfilling the obligations of the underlying loan agreement and applicable state law. 11 U.S.C. § 1123(d). By its terms, § 1123(d) requires that we look to the "underlying agreement," not only to the "predefault interest provisions" of the underlying agreement. To read any such limitation into § 1123(d) would be "to add specific language that Congress did not include in a carefully considered statute." Illinois v. Abbott & Assocs., Inc., 460 U.S. 557, 572, 103 S.Ct. 1356, 75 L.Ed.2d 281, (1983); see also United States v. Plaza Health Labs., Inc., 3 F.3d 643, 649 (2d Cir. 1993) ("[W]e cannot add to the statute what congress did not provide."). Here, the note provided that upon default, the interest rate on the loan would increase by 5 percent. Unfortunately for New Investments, the increased interest rate applies to the entirety of the note and not just to arrearages.

[10] [11] We are mindful that "[t]he principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor." Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007) (internal quotation marks omitted). And Congress wanted to protect debtors against unbargainedfor interest requirements in enacting § 1123(d). But the Bankruptcy Code is not a purely remedial statute. Fla. Dep't of Revenue v. Piccadilly Cafeterias, Inc., 554 U.S. 33, 51, 128 S.Ct. 2326, 171 L.Ed.2d 203 (2008). "Rather, Chapter 11 strikes a balance between a debtor's interest in reorganizing and restructuring its debts and the creditors' interest in maximizing the value of the bankruptcy estate." *Id.* If the loan agreement did not require a higher, postdefault interest rate, New Investments would not have to pay it. However, today's result holds New Investments to its bargain by adhering to the terms of its loan agreement with Pacifica, as required by § 1123(d).

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Both the text and the legislative history of § 1123(d) make clear that the provision was intended to limit parties to the benefit of their bargain when a debtor seeks to effectuate a cure and return to pre-default conditions. The parties bargained for a higher interest rate on the note in the event of default, and Pacifica is entitled to the benefit of that bargain under the terms of § 1123(d).

IV.

We conclude that Pacifica is entitled to receive payment of the loan at the post-default interest rate. We therefore reverse the decision of the bankruptcy court and remand for further proceedings.

REVERSED and REMANDED.

*1143 BERZON, Circuit Judge, dissenting:

Neither 11 U.S.C. § 1123(d) nor any other provision of the Bankruptcy Code provides a definition of "cure" contrary to the one this Court announced in *Great Western Bank & Trust v. Entz–White Lumber & Supply, Inc.* (*In re Entz–White Lumber &Supply, Inc.*), 850 F.2d 1338, 1340 (9th Cir. 1988). We are therefore bound by this Court's precedent, according to which New Investments may, in curing its default, pay the pre-default interest rate contained in the promissory note.

Instead of abiding by our longstanding case law, the majority concludes that Congress displaced *Entz–White* when it passed § 1123(d). Because neither the text of the statute nor the legislative history of § 1123(d) support the majority's departure, I dissent.

I.

Chapter 11 requires that a debtor's plan of reorganization "provide adequate means for the plan's implementation, such as ... curing or waiving of any default." 11 U.S.C. § 1123(a)(5). In the absence of any statutory definition, this Court held in *Entz–White* that "[c]uring a default" means "returning to pre-default conditions," such that any consequences of the default are "nullified." 850 F.2d at 1340 (quoting *Di Pierro v. Taddeo* (*In re Taddeo*), 685 F.2d 24, 26–27 (2d Cir. 1982)). Because curing a default

returns the debtor to the status quo ante, we concluded, "the power to cure under the Bankruptcy Code authorizes a plan to nullify all consequences of default, including avoidance of default penalties such as higher interest." *Id.* at 1342.

After this Court decided *Entz–White*, Congress enacted 11 U.S.C. § 1123(d). Section 1123(d), part of the 1994 amendments to the Bankruptcy Code, provides:

Notwithstanding subsection (a) of this section and sections 506(b), 1129(a)(7), and 1129(b) of this title, if it is proposed in a plan to cure a default the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.

Pacifica maintains—and the majority agrees—that this provision overruled *Entz—White* 's holding that a debtor who cures a default, thus "nullify[ing] all consequences of" that default, may repay arrearages at the pre-default interest rate. *See* 850 F.3d at 1342.

Pacifica bears the burden of showing that Congress, in passing § 1123(d), intended to change settled law. *Tome v. United States*, 513 U.S. 150, 163, 115 S.Ct. 696, 130 L.Ed.2d 574 (1995) (quoting *Green v. Bock Laundry Mach. Co.*, 490 U.S. 504, 521, 109 S.Ct. 1981, 104 L.Ed.2d 557 (1989)). In determining whether Pacifica has met this burden, we "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Hamilton v. Lanning*, 560 U.S. 505, 517, 130 S.Ct. 2464, 177 L.Ed.2d 23 (2010) (citations and internal quotation marks omitted).

Pacifica has not carried this burden, as both the statutory text and the legislative history of § 1123(d) support the continuing viability of *Entz–White* 's holding. The majority opinion errs in concluding otherwise, and, in doing so, wrongly imposes a severe penalty on debtors in New Investments' situation.

II.

The Bankruptcy Reform Act of 1994, among other things, added nearly identical language regarding how one cures

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a default to Chapters 11, 12, and 13 of the Bankruptcy Code. Pub. L. No. 103–394, § 305, 108 Stat. 4106 (1994). Like the subsection here at issue, 11 U.S.C. §§ 1222(d) *1144 and 1322(e) provide that, notwithstanding other provisions of the Bankruptcy Code not relevant here, "if it is proposed in a plan to cure a default, the amount necessary to cure the default, shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law."

Nowhere did the 1994 amendments define "cure a default" or suggest that this Circuit's then-operative definition of "cure" was incorrect. Rather, § 1123(d) indicates which materials the parties may consult in determining *how* to cure a default. Accordingly, as a result of the 1994 amendments, the *terms* of a cure are circumscribed by the underlying agreement and applicable nonbankruptcy law.

Neither § 1123(d) nor any other provision of the Bankruptcy Code explains where in the underlying agreement to look for the provisions that apply in the event of a cure. If, as *Entz–White* held, "[c]uring a default" means "returning to pre-default conditions," 850 F.2d at 1340, the provisions of the agreement setting out the predefault interest rate provide the relevant information. If "curing a default" means paying a penalty triggered by the default, the provisions of the agreement addressing higher post-default interest rates establish the relevant requirements. But in Entz-White, we decisively rejected this alternative definition of "cure." *Id.* at 1342. We called the creditor's argument in favor of this reading "spurious," as it "amount[ed] to saying, once more, that the higher rate of interest is not a consequence of default that can be cured." Id.

In short, the text of § 1123(d) makes clear that New Investments' cure will be based on the terms of the promissory note, but offers no guidance on which of the note's provisions governs here. *Entz–White* provides that guidance, by specifying that a "cure" permits the debtor to "avoid all consequences of the default." *Id.* Applying that understanding, it is the pre-default interest provisions of the underlying agreement that govern. The majority's conclusion that § 1123(d) overruled *Entz–White* has no basis in the text of the statute.

Ш.

The legislative history of § 1123(d) confirms that Congress did not mean to disturb this Court's holding in *Entz–White*. In adding § 1123(d), Congress focused on addressing an entirely separate matter—the Supreme Court's holding in *Rake v. Wade*, 508 U.S. 464, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993). H.R. Rep. No. 103–835, at 55 (1994); *see also* S. Rep. No. 103–168, at 53 (1993) (discussing the parallel provision included in the Senate bill).

In *Rake*, the Supreme Court held that an oversecured creditor was entitled to pre- and post-confirmation interest on mortgage arrearages paid to cure a default under a Chapter 13 plan. 508 U.S. at 471–75, 113 S.Ct. 2187. This reading of the relevant provisions of the Bankruptcy Code, §§ 506(b), 1322(b), and 1325(a)(5), permitted secured creditors to collect interest on top of the interest payments paid by debtors under their mortgages. *Id.* at 470–75, 113 S.Ct. 2187.

Congress overtly rejected this result in enacting § 1123(d). H.R. Rep. No. 103–835, at 55. The amendments to § 1123 were contained in § 305 of the Bankruptcy Reform Act of 1994, which is entitled "Interest on Interest." Pub. L. No. 103–394, § 305, 108 Stat. 4106, 4134 (1994). The relevant House Report states that the amendments "will have the effect of overruling the decision of the Supreme Court in *Rake v. Wade*," because *Rake* "had the effect of providing a windfall to secured creditors" by giving them "interest on interest payments, and interest on the late charges and other fees, even where applicable *1145 laws prohibit[] such interest and even when it was something that was not contemplated by either party in the original transaction." H.R. Rep. No. 103–835, at 55.

Far from repudiating *Entz–White* 's holding, the House Report reiterated *Entz–White* 's interpretation of "cure," stating, "[i]t is the Committee's intention that a cure pursuant to a plan should operate to put the debtor in the same position as if the default had never occurred." *Id.* The legislative history thus indicates, at the very least, that the new provision was not meant *sub silentio* to enact a definition of "cure" conflicting with that adopted in *Entz–White*. It also suggests that the relevant provisions of the "underlying agreement" for a "cure" are those that would have applied "if the default had never occurred." *See id.*

In sum, the pertinent 1994 amendments eliminated the possibility of a "court contrived windfall" for secured

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creditors. *Id.* Pacifica's challenge to the Bankruptcy Court's confirmation order does not implicate the concern that animated Congress. Like the text of the statute, the legislative history in no way suggests that *Entz–White* 's definition of "cure" is incorrect or was overruled.

Here, the underlying agreement provides both pre- and post-default interest rates. As the statute requires, we look to that agreement in determining which rates may apply. And in selecting which provision of the contract governs, we rely on our precedent and use the pre-default rate. New Investments therefore could cure the default by paying interest on the debt at the pre-default rate.

IV.

Notwithstanding its recitation of the relevant text and legislative history, the majority somehow concludes that *Entz–White* is no longer controlling. Relying on an incorrect interpretation of § 1123(d), the majority's opinion mistakenly upsets this Circuit's binding precedent.

A three judge panel of this Court is "bound by decisions of prior panels unless an en banc decision, Supreme Court decision or subsequent legislation undermines those decisions." *Gen. Const. Co. v. Castro*, 401 F.3d 963, 975 (9th Cir. 2005) (quoting *Benny v. U.S. Parole Comm'n*, 295 F.3d 977, 983 (9th Cir. 2002)). No act of Congress or intervening higher authority justifies the panel's departure from our precedent here.

As discussed, Congress has not defined "cure the default" in the years since we decided *Entz–White*. There is thus no

"clear indication that Congress intended ... a departure," Hamilton, 560 U.S. at 517, 130 S.Ct. 2464, from this Court's past practice. The interpretation of the statute best supported by the legislative record favors continuity. No intervening case law from the Supreme Court or the Ninth Circuit calls *Entz–White* into doubt. On the contrary, this Court has continued to rely on Entz-White's holding. See Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.), 314 F.3d 1070, 1075 (9th Cir. 2002) (concluding *Entz–White* precluded a creditor's argument "that a plan intended to nullify the consequences of a default (thereby avoiding the higher post-default interest rate) does not meet the purposes of the Bankruptcy Code"); cf. Gen. Elec. Capital Corp. v. Future Media Prods. Inc., 547 F.3d 956, 960–61 (9th Cir. 2008) (treating Entz-White as good law, but concluding it did not apply to a claim paid in full as a result of asset sales outside of a Chapter 11 plan).

Stare decisis thus requires us to apply Entz-White and hold that New Investments "is entitled to avoid all consequences of the default—including higher *1146 post-default interest rates." 850 F.2d at 1342. I would affirm the Bankruptcy Court order confirming New Investments' plan of reorganization, which reflects the pre-default interest rate included in the promissory note.

All Citations

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Footnotes

We reject New Investments's argument that Washington's deed of trust law cannot constitute "applicable nonbankruptcy law" under § 1123(d) because the Bankruptcy Code's automatic stay would prevent foreclosure under Washington law. See 11 U.S.C. § 362(a); Wash. Rev. Code Ann. § 61.24.040. This reading would render the phrase "applicable nonbankruptcy law" meaningless because the automatic stay would always trump state law foreclosure provisions, contrary to the statutory text and intent.

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In re Oyola, 571 B.R. 874 (2017)

571 B.R. 874 United States Bankruptcy Court, M.D. Florida, Tampa Division.

IN RE: Gloria OYOLA, Debtor.

Case No. 8:15-bk-08716-MGW | Signed August 24, 2017

Synopsis

Background: Chapter 7 debtor, a Colombian citizen who was not a permanent resident of the United States as of the petition date, claimed a Florida homestead exemption in the house in which she resided with her adult daughter, who was a permanent resident as of the petition date, and her minor granddaughter, a U.S. citizen. Trustee objected.

Holdings: The Bankruptcy Court, Michael G. Williamson, Chief Judge, held that:

- [1] for purposes of the Florida homestead exemption, the test for "family" is whether there exists (1) a legal duty to maintain arising out of the relationship, or (2) a continuing communal living by at least two individuals under circumstances where one is regarded as the person in charge, and
- [2] even if debtor, as a nonpermanent resident as of the petition date, could not legally intend to reside here permanently, she was living as a "family in fact" with her daughter and granddaughter, and so intended to make her home her family's permanent residence, such that she could claim the Florida homestead exemption.

Objection overruled.

West Headnotes (4)

[1] Child Support

Mult children

Under Florida law, a parent's duty to support a child generally ends when the child reaches the age of majority.

Cases that cite this headnote

[2] Homestead

Family relation in general

For purposes of the Florida homestead exemption, the test for "family" is whether there exists: (1) a legal duty to maintain arising out of the relationship, or (2) a continuing communal living by at least two individuals under circumstances where one is regarded as the person in charge.

Cases that cite this headnote

[3] Homestead

Family relation in general

For purposes of Florida homestead law, which recognizes both "family in law" and "family in fact," a "family in law" exists where there is a legal duty to maintain, whereas a "family in fact" exists where there is no legal duty to maintain but there is communal living by at least two individuals in circumstances where one is regarded as being in charge.

Cases that cite this headnote

[4] Homestead

Family relation in general

Even if Chapter 7 debtor, as a Colombian citizen who was not a permanent resident of the United States as of the petition date, could not legally intend to reside in the U.S. permanently, she was living in her house as a "family in fact" with her adult daughter, who was a permanent resident as of the petition date, and her minor granddaughter, who was a U.S. citizen, and so intended to make her home her family's permanent residence, such that she could claim the Florida homestead exemption; it was undisputed that debtor was living communally with her daughter and granddaughter and that her daughter and

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granddaughter recognized her as the person in charge.

Cases that cite this headnote

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ORDER AND MEMORANDUM OPINION OVERRULING TRUSTEE'S OBJECTION TO DEBTOR'S CLAIM OF EXEMPTIONS

Michael G. Williamson, Chief United States Bankruptcy Judge

Ordinarily, a debtor who is not a U.S. citizen cannot legally formulate the intent to reside here permanently for homestead purposes unless the debtor is a permanent resident as of the petition date. Here, the Debtor was not a permanent resident as of the petition date. So she cannot legally intend to reside here permanently. But the Debtor's adult daughter, who is living in the Debtor's house, was a permanent resident as of the petition date. And her minor granddaughter, who is also living in her house, was a U.S. citizen. Because the Florida Constitution permits an owner to claim property as homestead if the owner's family is living on the property, the Debtor is entitled to claim the homestead exemption.

*876 Background

The Debtor is a Colombian citizen. ¹ It appears she came to the United States, along with her daughter, sometime before 1997. ² Her initial basis for entry into the U.S. is unclear. But in June 1997, the Debtor married a U.S. citizen, ³ which would have made her immediately eligible for conditional permanent residence. ⁴ In two years, she could have had those conditions removed, making her eligible for permanent residence—i.e., a "green card." ⁵ For some reason, perhaps because her marriage ended

after only a few years, the Debtor never obtained her green card. 6

At some point, the Debtor apparently left the country, only to later return. It is undisputed, though, that the Debtor has been living in the U.S. since 2008 or so. The Debtor currently lives in her home at 12143 Armenia Gables Circle, Apt. #12143, Tampa, Florida, with her 30–year–old daughter, who was a permanent resident at the time this case was filed, as well her four-year-old granddaughter, who is a U.S. citizen.

In 2015, the Debtor filed for chapter 7 bankruptcy. ⁷ In her schedules, the Debtor claimed the Armenia Gables Circle property as exempt homestead. ⁸ There is no dispute the Debtor currently lives at the Armenia Gables Circle property and that she (subjectively) intends to reside there. ⁹ Although she will be eligible for a green card once her daughter becomes a citizen, which is expected to happen soon, the Debtor was not a permanent resident at the time she filed this case. ¹⁰

The Trustee objected to the Debtor's homestead exemption. ¹¹ Because the Debtor was not a permanent resident at the time she filed, the Trustee says the Debtor cannot legally form the intent to reside at the Armenia Gables Circle property permanently, which the Trustee argues is a requirement to claim the homestead exemption. ¹² The Court must now decide whether the fact that the Debtor was not a permanent resident as of the petition date bars her from claiming the homestead exemption.

Conclusions of Law

More than ten years ago, this Court, in *In re Fodor*, considered whether a debtor who was not a permanent resident as of the petition date could claim the homestead exemption. ¹³ In *Fodor*, the debtor was a Hungarian citizen. He married a U.S. citizen ten months before filing for bankruptcy, which meant he was eligible for conditional permanent resident status based on the marriage. ¹⁴ But the debtor did not obtain his conditional permanent residence until three months after filing for bankruptcy. ¹⁵ This Court ruled, in sustaining the objection to the Debtor's homestead exemption claim,

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that the debtor *877 could not legally formulate the intent to reside at his house permanently because he was not a permanent resident as of the petition date. ¹⁶

At first glance, the rationale for denying the homestead exemption in *Fodor* appears to apply equally here. Like the debtor in *Fodor*, the Debtor here was not a permanent resident as of the petition date. It's true that the Debtor will likely be eligible for permanent residence once her daughter becomes a U.S. citizen, which is expected to happen soon (or may have already happened). And that was true of the debtor in *Fodor*. In fact, the debtor in *Fodor* actually obtained his permanent residence just three months after the petition date. But that was not enough to support the homestead exemption. The Debtor, however, argues the Court should follow the Third District Court of Appeal's decision five years ago in *Grisolia v. Pfeffer*. ¹⁷

In *Grisolia*, the Third District Court of Appeal held that a Venezuelan citizen here on a temporary visa could claim the homestead exemption. ¹⁸ In that case, Favio Grisolia Sanchez and Ivonne Grisolia, both Venezuelan citizens, moved to the U.S. after a kidnapping attempt on their son, a U.S. citizen, who was four years old at the time. ¹⁹ Later, Favio died, and two of his creditors made a claim against his estate. In response, his estate sought a determination from the probate court that Favio's apartment, where his wife and son were still living, was exempt homestead. ²⁰ After the probate court denied the homestead claim, his estate appealed.

On appeal, the *Grisolia* court, relying on the Florida Supreme Court's decision in *In re Cooke*, correctly noted that the Florida Constitution permits an owner to claim property as homestead, even if the owner is not living there, so long as the owner's family is living on the property:

The Florida Supreme Court has addressed the issue of homestead exemption and held that "although it is not necessary that the head of the family reside in the state or intend to make the property in question his permanent residence, he must establish that he intended to make his property his family's permanent residence." We have also acknowledged that article X, section 4(a)(1) specifies that a homestead exemption is limited to the residence of the owner or the owner's family and, "[a]ccordingly, 'the Florida Constitution does not

require that the owner claiming homestead exemption reside on the property; it is sufficient that the owner's family reside on the property.' "21

The *Grisolia* court noted that in *Cooke*, the Florida Supreme Court rejected the homestead claim by Canadian citizens temporarily in the U.S. because none of them had the legal right to reside in Florida. ²² But in *Grisolia*, Favio's son, who was a U.S. citizen, had the legal right to reside in Florida permanently, so the *Grisolia* court held that the probate court was wrong in determining the property was not homestead. ²³

*878 This case is similar to *Grisolia* in one significant respect. Like in *Grisolia*, the Debtor's family has the legal right to reside in Florida permanently. Here, the Debtor's daughter is a permanent resident (and may be a citizen); and the Debtor's granddaughter is a U.S. citizen. But the cases are different in one crucial respect: unlike in *Grisolia*, the Debtor's daughter is not a minor. This case, then, turns on whether the homestead exemption's protection of a family residence extends to property occupied by the owner and her adult child.

Within the last ten years, two Florida bankruptcy courts have refused to extend the homestead exemption to property occupied by a debtor's adult child. 24 In In re Wilson, the court allowed the debtor to claim a 640-square-foot apartment above a nightclub as homestead. 25 But the court rejected the debtor's contention that because his son lived in a room in the nightclub, the nightclub was part of the debtor's homestead. ²⁶ More recently, in *In re Fowler*, the debtor claimed two adjoining parcels—one occupied by the debtor and the other by her adult daughter-were homestead. 27 Although the court allowed the debtor to exempt the parcel she lived in, it ruled the fact that the debtor's daughter lived in the second parcel did not justify extending the homestead exemption to that parcel. ²⁸ The basis underlying both decisions was the same: While the homestead exemption protects property occupied by the owner's family, adult children are not "family" for homestead purposes. 29

[1] In determining that the adult children were not "family" for homestead purposes, both courts articulated

the test for determining whether a "family" exists as follows:

For purposes of the homestead exemption, the test for family is: "(1) A legal duty to maintain arising out of the relationship *and* (2) a continuing communal living by at least two individuals under circumstances where one is regarded as the person in charge." Under this test, the "head of the family must not only be obligated to, but must actually support such dependents." ³⁰

Because under Florida law, a parent's duty to support a child generally ends when the child reaches the age of majority, both courts concluded no "family" existed for homestead purposes under the first test. ³¹

[2] Although it doesn't appear that the debtor in either case would have satisfied the second test, *Wilson* and *Fowler* could be read to suggest that it was unnecessary to address the second test because the debtors in both cases failed the first one. After all, the court in both cases use the conjunctive "and" to join the tests. And in both cases, the court declined to address the second test after concluding the debtor failed the first one. The tests articulated by the *Wilson* and *Fowler* courts, however, should actually be read in the disjunctive.

Both Wilson and Fowler trace the tests for "family" back to the First District Court of Appeal's decision in Heard v. Mathis. 32 But the Heard court prefaced the language Wilson and Fowler quote by *879 stating that the "tests" (plural) "must be met either singly or in combination." 33 "Singly," of course, means "individually." ³⁴ Moreover, the source for the tests articulated in Heard, and later in Wilson and Fowler, is a law review article by Harold Crosby and George Miller attempting to delineate the main principles of the homestead exemption. 35 After noting that much of the homestead litigation had centered on the meaning of family headship, Crosby and Miller explained in their law review article that the reported decisions (which were too numerous to cite) revealed that courts at the time had traditionally followed the two tests, "which may be met together or in the alternative." 36

[3] This is consistent with how Florida courts have since treated the homestead exemption. Numerous Florida courts have explained that Florida homestead law

recognizes both "family in law" and "family in fact." ³⁷ A "family in law" exists where there is a legal duty to maintain. ³⁸ A "family in fact" exists where there is no legal duty to maintain but there is communal living by at least two individuals in circumstances where one is regarded as being in charge. ³⁹ Some courts have explained that the "family in fact" arises out of a moral—rather than legal—duty to support. ⁴⁰

[4] Here, there is no "family in law." Because the Debtor's daughter has reached the age of majority, the Debtor no longer has a legal obligation to support her. The Debtor's granddaughter is a minor. But the Court is unaware of any legal obligation for the Debtor to support her granddaughter. The Court does conclude, however, that there is a "family in fact."

More than a century ago, in *Caro v. Caro*, the Florida Supreme Court recognized that a parent and adult children can constitute a "family" for homestead purposes. ⁴¹ There, Mary Caro devised her home to two daughters she was living with. ⁴² Caro's other heirs challenged the devise under article X, section 1 of the 1885 Florida Constitution, which prohibited a head of family from disposing of their homestead by will. ⁴³

On appeal, the Florida Supreme Court held that Caro was a head of family for homestead purposes. The Court noted that the parties had stipulated that Caro's two daughters who inherited the home had been living with Caro continuously. Although Caro supplied the food for the household, both her daughters had been earning enough money through their sewing to supply all their wants (except their food). The daughters had kept house, *880 tended to Caro's personal wants, and tended to her outside business affairs. The Florida Supreme Court held those stipulated facts were sufficient to support a finding that Caro was the head of family, even though her daughters were no longer minors.

Here, the Court concludes the Debtor is living as a family with her adult daughter and minor granddaughter. In fact, at no point has the Trustee disputed that the Debtor is living communally with her daughter and granddaughter and that her daughter and granddaughter recognize her as the person in charge. The Trustee's only opposition

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to the exemption is that the Debtor cannot have the intent to reside here permanently, which is irrelevant if the Debtor intends to make her home her family's permanent residence.

Conclusion

It may be true, as the Trustee argues, that the Debtor cannot legally intend to reside here permanently. But as the Florida Supreme Court explained more than 30 years ago, ⁴⁸ a property owner need not reside here permanently so long as she intends for her family to do so. Because the Debtor intends for her daughter and granddaughter to reside here permanently, she is entitled to claim the homestead exemption.

Accordingly, it is

ORDERED:

- 1. The Trustee's objection to the Debtor's homestead exemption claim is OVERRULED.
- 2. The Debtor's home located at 12143 Armenia Gables Circle, Apt. #12143, Tampa, Florida, is exempt homestead.

All Citations

571 B.R. 874

Footnotes

- 1 Doc. No. 14 at Ex. A.
- 2 Id. at ¶ 8.
- 3 Id.
- 4 8 U.S.C. § 1186a.
- 5
 Id
- 6 Doc. No. 14 at ¶ 8.
- 7 Doc. No. 1.
- 8 Id. at Schedule C.
- 9 Doc. No. 14 at ¶ 7.
- 10 Id.
- 11 Doc. No. 11.
- 12 *Id.* at ¶ 5.
- 13 339 B.R. 519, 522 (Bankr. M.D. Fla. 2006).
- 14 *Id.* at 520 (citing 8 U.S.C. § 1186a(2000)).
- 15 *Id.* at 520.
- 16 Id. at 523.
- 17 77 So.3d 732 (Fla. 3d DCA 2011).
- 18 Id. at 736.
- 19 Id. at 733.
- 20 la
- 21 Id. at 734 (quoting In re Cooke (Cooke v. Uranksy), 412 So.2d 340, 343 (Fla. 1982)) (citations omitted).
- 22 *Id.* (discussing *Cooke*, 412 So.2d at 343).
- 23 *Id.* at 736.
- 24 In re Fowler, 2016 WL 1444195, at *2 (Bankr. M.D. Fla. 2016); In re Wilson, 393 B.R. 778, 783–84 (Bankr. S.D. Fla. 2008).
- **25** *Wilson*, 393 B.R. at 782.
- 26 Id. at 783–84.
- 27 Fowler, 2016 WL 1444195, at *1.
- 28 *Id.* at 2–3.
- 29 Wilson, 393 B.R. at 783; Fowler, 2016 WL 1444195, at *2.

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- 30 Wilson, 393 B.R. at 783 (quoting Heard v. Mathis, 344 So.2d 651, 654 (Fla. 1st DCA 1977)) (emphasis added) (citations omitted); Fowler, 2016 WL 1444195, at *2 (quoting Wilson) (citations omitted).
- 31 Wilson, 393 B.R. at 783; Fowler, 2016 WL 1444195, at *2.
- 32 344 So.2d 651, 654 (Fla. 1st DCA 1977).
- 33 Id.
- 34 Merriam-Webster Dictionary, https://www.merriam-webster.com/dictionary/singly.
- 35 Id. (citing Crosby & Miller, Our Legal Chameleon, The Florida Homestead Exemption, 2 U. Fla. L. Rev. 12 (1949)).
- 36 Id. at 24 (emphasis added).
- 37 See, e.g., Flannery v. Green, 482 So.2d 400, 402 (Fla. 2d DCA 1985); Routman v. Desvarieux, 467 So.2d 1090, 1090 n.1 (Fla. 3d DCA 1985); In re Schorr's Estate, 409 So.2d 487, 489–90 (Fla. 4th 1981).
- 38 Flannery, 482 So.2d at 402; Routman, 467 So.2d at 1090 n.1.
- 39 Flannery, 482 So.2d at 402; Routman, 467 So.2d at 1090 n.1.
- 40 Routman, 467 So.2d at 1090 n.1; In re Rivera, 5 B.R. 313, 315 (Bankr. M.D. Fla. 1980).
- 41 45 Fla. 203, 34 So. 309 (Fla. 1903).
- 42 Id. at 206, 34 So. 309.
- 43 *Id.* at 207, 34 So. 309.
- 44 *Id.* at 206, 34 So. 309.
- 45 *Id.*
- 46 Id.
- 47 Id. at 207, 34 So. 309.
- 48 In re Cooke (Cooke v. Uranksy), 412 So.2d 340, 341 (Fla. 1982).

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KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Ryan, Bankr.D.Hawai'i, October 19, 2016
838 F.3d 1170
United States Court of Appeals,
Eleventh Circuit.

IN RE: David A. FAILLA, Donna N. Failla, Debtors.

David A. Failla and Donna N.

Failla, Plaintiffs—Appellants,

Citibank, N.A., Defendant-Appellee.

No. 15-15626 | Date Filed: 10/04/2016

Synopsis

Background: Residential mortgagee filed motion to compel Chapter 7 debtors to surrender mortgaged property pursuant to their filed statement of intention. The United States Bankruptcy Court for the Southern District of Florida, Paul G. Hyman, Jr., Chief Judge, 529 B.R. 786, granted motion, and debtors appealed. The District Court, Kenneth A. Marra, J., 542 B.R. 606, affirmed. Debtors appealed.

Holdings: The Court of Appeals, William Pryor, Circuit Judge, held that:

- [1] debtors who file a statement of intent to surrender the property that collateralizes secured debt must perform that intent by surrendering the property both to trustee and to creditor;
- [2] to "surrender" real property securing residential mortgage debt, in accordance with their stated intent, Chapter 7 debtors had to drop their opposition to state court foreclosure action:
- [3] bankruptcy judge had authority to remedy debtors' abuse of bankruptcy process by directing debtors to withdraw their affirmative defenses and dismiss their counterclaim in state court foreclosure action.

Affirmed.

West Headnotes (20)

[1] Bankruptcy

Scope of review in general

On appeal from district court's decision in its bankruptcy appellate capacity, the Court of Appeals assesses bankruptcy court's judgment anew, employing same standard of review that the district court itself used.

2 Cases that cite this headnote

[2] Bankruptcy

Conclusions of law; de novo review

Bankruptcy

Clear error

On appeal from district court's decision in its bankruptcy appellate capacity, the Court of Appeals reviews bankruptcy court's factual findings for clear error, and its legal conclusions de novo. Fed. R. Bankr. P. 8013.

3 Cases that cite this headnote

[3] Bankruptcy

Secured Claims

Bankruptcy

Debtor's duties in general

Statement of intention that debtor is required to file with respect to the property collateralizing secured debt must declare one of four things: that collateral is exempt, that debtor will surrender the collateral, that debtor will redeem the collateral, or that debtor will reaffirm debt. 11 U.S.C.A. § 521(a) (2)(A).

5 Cases that cite this headnote

[4] Bankruptcy

Secured Claims

Bankruptcy

Effect

Debtors who file a statement of intent to surrender the property that collateralizes

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secured debt must perform that intent by surrendering the property both to trustee and to creditor; thus, even if trustee abandons the property, debtors' duty to surrender the property to the secured creditor remains. 11 U.S.C.A. § 521(a)(2)(B).

2 Cases that cite this headnote

[5] Statutes

Superfluousness

No provision of statute should needlessly be given an interpretation that causes it to duplicate another provision.

Cases that cite this headnote

[6] Bankruptcy

Secured Claims

Bankruptcy

Effect

Debtor who files a statement of intent to surrender the property that collateralizes secured debt performs in accordance with stated intent by first surrendering the property to trustee, who decides whether to liquidate it or abandon it, and if trustee abandons it, then debtor performs by surrendering property to creditor. 11 U.S.C.A. § 521(a)(2)(B), (a)(4).

3 Cases that cite this headnote

[7] Statutes

Context

Context is a primary determinant of meaning of statutory provisions.

Cases that cite this headnote

[8] Bankruptcy

Secured Claims

Mortgages and Deeds of Trust

Defenses to Foreclosure

To "surrender" real property securing residential mortgage debt, in accordance with their stated intent, Chapter 7 debtors

had to drop their opposition to state court foreclosure action. 11 U.S.C.A. § 521(a)(2)(B).

3 Cases that cite this headnote

[9] Bankruptcy

Secured Claims

Term "surrender," as used in bankruptcy statute authorizing debtors to deal with property that collateralizes secured debt by surrendering it, could not be interpreted as meaning to give or deliver up possession upon compulsion or demand, but had to be understood as the giving up of a right or claim. 11 U.S.C.A. §§ 521(a)(2), 1325(a)(5)(C).

Cases that cite this headnote

[10] Statutes

Undefined terms

Undefined statutory terms must be given their contextually appropriate ordinary meaning.

Cases that cite this headnote

[11] Statutes

Similarity or difference

Statutory word or phrase is presumed to bear the same meaning throughout a text.

Cases that cite this headnote

[12] Statutes

Similarity or difference

Material variation in statutory terms suggests a variation in meaning.

Cases that cite this headnote

[13] Bankruptcy

Secured Claims

Debtors who "surrender" collateral, as that term is used in the Bankruptcy Code, must get out of the secured creditor's way.

Cases that cite this headnote

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[14] Bankruptcy

Secured Claims

Mortgages and Deeds of Trust

Defenses to Foreclosure

Hanging subparagraph at end of bankruptcy statute requiring debtors to file statement of intent with respect to property that collateralizes a secured debt, which states that "nothing in [the preceding] subparagraphs... shall alter the debtor's or the trustee's rights with regard to such property," did not give Chapter 7 debtors, who had indicated that it was their intent to surrender residential mortgaged property, the right to subsequently oppose mortgagee's attempts to foreclose; hanging paragraph meant merely that nothing in preceding subparagraphs affected debtor's or trustee's "bankruptcy" rights, such as protections of automatic stay or right to insist that mortgagee obtain stay relief prior to foreclosing. 11 U.S.C.A. § 521(a)(2).

1 Cases that cite this headnote

[15] Bankruptcy

Secured Claims

Mortgages and Deeds of Trust

Defenses to Foreclosure

Chapter 7 debtors could not say one thing in bankruptcy court, by indicating that it was their intent to surrender the property securing their residential mortgage debt, and another thing in state court, by opposing mortgagee's attempts to foreclose on property; in bankruptcy as in life, they did not get to have their cake and eat it too. 11 U.S.C.A. § 521(a)(2)(B).

2 Cases that cite this headnote

[16] Bankruptcy

Presentation of grounds for review

While the Court of Appeals generally will not consider an issue not raised below, the Court, on appeal from district court's decision in its bankruptcy appellate capacity, could consider a new argument never raised below, where argument presented a pure question of law whose proper resolution was beyond any doubt, and where argument was intertwined with other arguments raised by appellants.

Cases that cite this headnote

[17] Bankruptcy

Power and Authority

Bankruptcy

Secured Claims

Bankruptcy

Debtor's duties in general

Bankruptcy courts have broad powers to remedy violations of the mandatory duties imposed on debtors with regard to property that collateralizes secured debt. 11 U.S.C.A. § 521(a)(2).

Cases that cite this headnote

[18] Bankruptcy

Power and Authority

Bankruptcy judges have broad authority to take any action that is necessary or appropriate to prevent an abuse of process. 11 U.S.C.A. § 105(a).

Cases that cite this headnote

[19] Bankruptcy

Secured Claims

Liens

Enforcement

Debtor who promises to surrender property in bankruptcy court and then, once his debts are discharged, breaks that promise by opposing a foreclosure action in state court has abused the bankruptcy process.

2 Cases that cite this headnote

[20] Bankruptcy

In general; standing

Bankruptcy

Secured Claims

Mortgages and Deeds of Trust

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Waiver, estoppel, and consent

While residential mortgagee frustrated in its attempts to foreclose on property that debtors, while their bankruptcy case was pending, had purported to surrender might be able to invoke doctrine of judicial estoppel in state court to prevent debtors from opposing its foreclosure action, availability of equitable remedy like judicial estoppel did not affect statutory authority of bankruptcy judge to remedy Chapter 7 debtors' abuse of bankruptcy process by directing debtors to withdraw their affirmative defenses and dismiss their counterclaim in state court foreclosure action. 11 U.S.C.A. §§ 105(a), 521(a)(2).

4 Cases that cite this headnote

*1173 Appeal from the United States District Court for the Southern District of Florida, D.C. Docket No. 9:15– cv–80328–KAM, Bkcy No. 9:11–bkc–34324–PGH

Attorneys and Law Firms

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Before MARCUS and WILLIAM PRYOR, Circuit Judges, and LAWSON, * District Judge.

Opinion

WILLIAM PRYOR, Circuit Judge:

This appeal requires us to decide whether a person who agrees to "surrender" his house in bankruptcy may oppose a foreclosure action in state court. David and Donna Failla filed for bankruptcy in 2011 and agreed that they would surrender their house to discharge their mortgage debt. But the Faillas continued to oppose a foreclosure

proceeding in state court. Citibank then filed a motion to compel surrender in the bankruptcy court and argued that the Faillas had breached their duty to surrender the property. The bankruptcy court granted the motion, and the district court affirmed. Because the word "surrender" in the bankruptcy code, 11 U.S.C. § 521(a)(2), requires that debtors relinquish their right to possess the property, we affirm.

I. BACKGROUND

David and Donna Failla own a house in Boca Raton, Florida. They financed their purchase with a \$500,000 mortgage. The Faillas defaulted on that mortgage in 2009. Citibank, the owner of the mortgage and the promissory note, filed a foreclosure action in a Florida court. The Faillas are opposing that foreclosure action.

The Faillas filed for bankruptcy in 2011. During the bankruptcy proceedings, the Faillas admitted that they own the house, that the house is collateral for the mortgage, that the mortgage is valid, and that the balance of the mortgage exceeds the value of the house. They also filed a statement of intention, 11 U.S.C. § 521(a)(2), to surrender the house. Because the house had a negative value, the trustee "abandoned" it back to the Faillas, 11 U.S.C. § 554. The Faillas continue to live in the house while they contest the foreclosure action.

Citibank filed a motion to compel surrender in the bankruptcy court. Citibank argued that the Faillas' opposition to the foreclosure action contradicted their statement *1174 of intention to surrender the house. The Faillas argued that their opposition to the foreclosure action is not inconsistent with surrendering the house.

The bankruptcy court granted Citibank's motion to compel surrender and ordered the Faillas to stop opposing the foreclosure action. *See In re Failla*, 529 B.R. 786, 793 (Bankr. S.D. Fla. 2014). The bankruptcy court explained that if the Faillas do not comply with its order, it may "enter an order vacating [their] discharge." *Id.* The district court affirmed on appeal. *See Failla v. Citibank, N.A.*, 542 B.R. 606, 612 (S.D. Fla. 2015).

The Faillas now appeal to this Court. After the parties filed their briefs, Citibank filed a motion to strike portions of the Faillas' briefing that were raised for the first time on

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appeal. The disputed sections argue that the only remedy available to the bankruptcy court was lifting the automatic stay for Citibank, which would allow Citibank to foreclose on the house in the ordinary course. This Court ruled that the motion to strike should be carried with the case.

II. STANDARD OF REVIEW

[1] [2] "Because the district court functions as an appellate court in reviewing bankruptcy court decisions, this court is the second appellate court to review bankruptcy court cases." *In re Glados, Inc.*, 83 F.3d 1360, 1362 (11th Cir. 1996). We "assess the bankruptcy court's judgment anew, employing the same standard of review the district court itself used." *In re Globe Mfg. Corp.*, 567 F.3d 1291, 1296 (11th Cir. 2009). "Thus, we review the bankruptcy court's factual findings for clear error, and its legal conclusions *de novo*." *Id.*

III. DISCUSSION

We divide our discussion in two parts. First, we explain that section 521(a)(2) prevents debtors who surrender their property from opposing a foreclosure action in state court. Second, we explain that the bankruptcy court had the authority to order the Faillas to stop opposing their foreclosure action.

- A. Debtors Who Surrender Their Property in Bankruptcy May Not Oppose a Foreclosure Action in State Court.
- [3] Section 521(a)(2) states a bankruptcy debtor's responsibilities when his schedule of assets and liabilities includes mortgaged property:
 - (a) The debtor shall ...
 - (2) if an individual debtor's schedule of assets and liabilities includes debts which are secured by property of the estate—
 - (A) within thirty days after the date of the filing of a petition under chapter 7 of this title or on or before the date of the meeting of creditors, whichever is earlier, or within such additional time as the court, for cause, within such period fixes, file with the clerk a statement of his intention with respect to

the retention or surrender of such property and, if applicable, specifying that such property is claimed as exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property; and

(B) within 30 days after the first date set for the meeting of creditors under section 341(a), or within such additional time as the court, for cause, within such 30-day period fixes, perform his intention with respect to such property, as specified *1175 by subparagraph (A) of this paragraph;

except that nothing in subparagraphs (A) and (B) of this paragraph shall alter the debtor's or the trustee's rights with regard to such property under this title, except as provided in section 362(h).

11 U.S.C. § 521(a)(2). Subsection (A) requires the debtor to file a statement of intention about what he plans to do with the collateral for his debts. See Fed. R. Bankr. P. 1007(b)(2). The statement of intention must declare one of four things: the collateral is exempt, the debtor will surrender the collateral, the debtor will redeem the collateral, or the debtor will reaffirm the debt. See In re Taylor, 3 F.3d 1512, 1516 (11th Cir. 1993). After the debtor issues his statement of intention, subsection (B) requires him to perform the option he declared. Id.

The question here is whether the Faillas satisfied their declared intention to surrender their house under section 521(a)(2)(B). To answer that question, we must decide to whom debtors must surrender their property and whether surrender requires debtors to acquiesce to a creditor's foreclosure action. The district court and the bankruptcy court correctly concluded that the Faillas violated section 521(a)(2) by opposing Citibank's foreclosure action after filing a statement of intention to surrender their house.

- [4] We agree with both the district court and the bankruptcy court that section 521(a)(2) requires debtors who file a statement of intent to surrender to surrender the property both to the trustee and to the creditor. Even if the trustee abandons the property, the debtors' duty to surrender the property to the creditor remains. The text and the context of the statute compel this interpretation.
- [5] Reading "surrender" to refer only to the trustee of the bankruptcy estate renders section 521(a)(2) superfluous with section 521(a)(4). Under the surplusage canon, no

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provision "should needlessly be given an interpretation that causes it to duplicate another provision." Antonin Scalia & Bryan A. Garner, *Reading Law* 174 (2012). *See also Inhabitants of Montclair Twp. v. Ramsdell*, 107 U.S. 147, 152, 2 S.Ct. 391, 27 L.Ed. 431 (1883) ("It is the duty of the court to give effect, if possible, to every clause and word of a statute...."). Section 521(a)(4) states that "[t]he debtor shall ... surrender to the trustee all property of the estate." 11 U.S.C. § 521(a)(4). Because section 521(a)(4) already requires the debtor to surrender all of his property to the trustee so the trustee can decide, for example, whether to liquidate it or abandon it, section 521(a)(2) must refer to some other kind of surrender.

When the bankruptcy code means a debtor must surrender his property either to the creditor or the trustee, it says so. On the one hand, section 1325(a)(5)(C) states that "the debtor surrenders the property securing such claim to such holder," which clearly contemplates surrender to a creditor. 11 U.S.C. § 1325(a)(5)(C) (emphasis added). Congress did not use that language here. On the other hand, section 521(a)(4) states that "[t]he debtor shall ... surrender to the trustee all property of the estate," which clearly contemplates surrender to the trustee. Id. § 521(a) (4) (emphasis added). Congress did not use that language either.

[6] What Congress *did* say in section 521(a)(2) is "surrender," without specifying to whom the surrender is made. But the lack of an object makes sense because a debtor who decides to surrender his collateral must surrender it to *both* the trustee and the creditor. The debtor first surrenders *1176 it to the trustee, *id.* § 521(a)(4), who decides whether to liquidate it, *id.* § 704(a)(1), or abandon it, *id.* § 554. If the trustee abandons it, then the debtor surrenders it to the creditor, *id.* § 521(a)(2).

[7] The word "surrender" in section 521(a)(2) is used with reference to the words "redeem" and "reaffirm," and those words plainly refer to creditors. A debtor "redeems" property by paying the creditor a particular amount, and he "reaffirms" a debt by renegotiating it with the creditor. See Taylor, 3 F.3d at 1514 n.2; see also 11 U.S.C. §§ 524(c), 722. Because "[c]ontext is a primary determinant of meaning," Scalia & Garner, supra, at 167, the word "surrender" likely refers to a relationship with a creditor as well. We said as much in dicta in Taylor. See 3 F.3d at 1514 n.2 ("Surrender provides that a debtor surrender the

collateral *to the lienholder* who then disposes of it pursuant to the requirements of state law." (emphasis added)).

Other provisions of the bankruptcy code that provide a remedy to creditors when a debtor violates section 521(a)(2) suggest that the word "surrender" does not refer exclusively to the trustee. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 305, 119 Stat. 23, added two sections to the bankruptcy code that provide remedies for creditors with respect to personal property. 11 U.S.C. §§ 362(h), 521(d). Section 362(h) punishes a debtor who violates section 521(a)(2) by lifting the automatic stay, which allows the creditor to pursue other remedies against the debtor immediately. 11 U.S.C. § 362(h)(1). Section 362(h) allows the trustee of the bankruptcy estate to override this remedy, but only if the trustee moves the court to "order[] appropriate adequate protection of the creditor's interest." Id. § 362(h)(2). And section 521(d) allows a creditor to consider the debtor in default because he declared bankruptcy if the debtor violates section 521(a) (2). See id. § 521(d).

That these remedies apply only to personal property is irrelevant. Section 521(a)(2) uses the generic word "property" and draws no distinction between real and personal property. Congress provided additional remedies for creditors secured by personal property, but the contextual clue remains the same. These remedies for creditors reflect an obvious point about section 521(a)(2): it is a provision that affects and protects the rights of creditors.

[10] [11] [12] We also agree with the bankruptcy court and the district court that "surrender" requires debtors to drop their opposition to a foreclosure action. The bankruptcy code does not define the word "surrender," so we give it its "contextually appropriate ordinary meaning." Scalia & Garner, supra, at 70; see also In re Piazza, 719 F.3d 1253, 1261 (11th Cir. 2013) (applying this canon to the bankruptcy code). One meaning of "surrender" is "to give or deliver up possession of (anything) upon compulsion or demand." Surrender, Webster's New International Dictionary 2539 (2d ed. 1961); see also Surrender, Oxford English Dictionary (online ed.) ("To give up (something) out of one's own possession or power into that of another who has or asserts a claim to it.") (all Internet materials as visited Sept. 15, 2016, and available in Clerk of Court's case file). But this meaning is

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not contextually appropriate. When the bankruptcy code means "physically turn over property," it uses the word "deliver" instead of "surrender." *See, e.g.,* 11 U.S.C. §§ 542(a), 543(b)(1); *see also id.* § 727(d)(2) (using the phrase "deliver or surrender," which suggests they are different). The presumption of consistent usage instructs that "[a] word or phrase is presumed to bear the same meaning throughout a text" and that "a material variation in terms suggests a variation in meaning." *1177 Scalia & Garner, *supra*, at 170; *see also Russello v. United States*, 464 U.S. 16, 23, 104 S.Ct. 296, 78 L.Ed.2d 17 (1983).

Another meaning of "surrender" is "[t]he giving up of a right or claim." Surrender, Black's Law Dictionary (10th ed. 2014); see also Surrender, Webster's New International Dictionary 2539 ("To give up completely; to resign; relinquish; as, to surrender a right, privilege, or advantage."). This meaning describes a legal relationship, as opposed to a physical action, which makes sense in the context of section 521(a)(2)—a provision that describes other legal relationships like "reaffirmation" and "redemption." This definition is in line with existing authorities. See In re Pratt, 462 F.3d 14, 18-19 (1st Cir. 2006) ("[T]he most sensible connotation of 'surrender' in the ... context [of section 521(a)(2)] is that the debtor agreed to make the collateral available to the secured creditor-viz., to cede his possessory rights in the collateral...."); In re White, 487 F.3d 199, 205 (4th Cir. 2007) ("[T]he word 'surrender' [in section 1325(a)(5) (C)] means the relinquishment of all rights in property, including the possessory right, even if such relinquishment does not always require immediate physical delivery of the property to another."); In re Plummer, 513 B.R. 135, 143-44 (Bankr. M.D. Fla. 2014); 8 Collier on Bankruptcy § 1325.06[4] (16th ed.) ("Surrender in th[e] context [of section 1325(a)(5)(C)] means simply the relinquishment of any rights in the collateral.").

[13] Because "surrender" means "giving up of a right or claim," debtors who surrender their property can no longer contest a foreclosure action. When the debtors act to preserve their rights to the property "by way of adversarial litigation," they have not "relinquish[ed] ... all of their legal rights to the property, including the rights to possess and use it." White, 487 F.3d at 206 (emphasis omitted). The "retention of property that is legally insulated from collection is inconsistent with surrender." Id. at 207. Ordinarily, when debtors surrender property to a creditor, the creditor obtains it immediately

and is free to sell it. Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 962, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997). Granted, a creditor must take *some* legal action to recover real property—namely, a foreclosure action. See Fla. Stat. Ann. §§ 702.01–702.11. Foreclosure proceedings ensure that debtors do not have to determine unilaterally issues of priority if there are multiple creditors or surplus if the value of the property exceeds the liability. See *Plummer*, 513 B.R. at 144. Debtors who surrender property must get out of the creditor's way. "[I]n order for surrender to mean anything in the context of § 521(a)(2), it has to mean that ... debtor[s] ... must not contest the efforts of the lienholder to foreclose on the property." In re Elowitz, 550 B.R. 603, 607 (Bankr. S.D. Fla. 2016). Otherwise, debtors could obtain a discharge in bankruptcy based, in part, on their sworn statement to surrender and "enjoy possession of the collateral indefinitely while hindering and prolonging the state court process." Id. (quoting In re Metzler, 530 B.R. 894, 900 (Bankr. M.D. Fla. 2015)).

[14] The hanging paragraph in section 521(a)(2) also does not give the debtor the right to oppose a foreclosure action. The hanging paragraph states that "nothing in subparagraphs (A) and (B) of this paragraph shall alter the debtor's or the trustee's rights with regard to such property under this title, except as provided in section 362(h)." 11 U.S.C. § 521(a)(2). The key words for purposes of this dispute are "under this title." The hanging paragraph means that section 521(a)(2) does not affect the debtor's or the trustee's bankrupt *1178 cy rights. Section 521(a) (2) does not affect the trustee's bankruptcy rights because a debtor must first surrender property to the trustee who liquidates it or abandons it—before surrendering it to the creditor. See id. § 521(a)(4). And section 521(a)(2) does not affect the debtor's bankruptcy rights because a creditor is still subject to the automatic stay and cannot foreclose on the property until the trustee decides to abandon it. The hanging paragraph spells out an order of operations. It does not mean that a debtor who declares he will surrender his property can then undo his surrender after the bankruptcy is over and the creditor initiates a foreclosure action.

[15] Concerns about fairness are not in tension with this outcome. During the bankruptcy proceedings, the Faillas declared that they would surrender the property, that the mortgage is valid, and that Citibank has the right to foreclose. Compelling them to stop opposing the foreclosure action requires them to honor that

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declaration. The Faillas may not say one thing in bankruptcy court and another thing in state court:

The concern here is that the Debtor is making a mockery of the legal system by taking inconsistent positions. In an effort to obtain her chapter 7 discharge, the Debtor swears—under the penalty of perjury—an intention to "surrender" her property. In other words, the Debtor is representing to the Court that she will make her property available to the Bank by refraining from taking any overt act that impedes the Bank's ability to foreclose its interest in the property. Yet, once she receives her discharge, the Debtor in fact impedes the Bank's ability to foreclose its mortgage.

In re Guerra, 544 B.R. 707, 710 (Bankr. M.D. Fla. 2016). In bankruptcy, as in life, a person does not get to have his cake and eat it too.

Section 521(a)(2) requires a debtor to either redeem, reaffirm, or surrender collateral to the creditor. Having chosen to surrender, the debtor must drop his opposition to the creditor's subsequent foreclosure action. Because the Faillas filed a statement of intention to surrender their house, they cannot contest the foreclosure action.

B. The Bankruptcy Court Had the Authority to Order the Faillas to Stop Opposing the State Foreclosure Action.

For the first time on appeal, the Faillas argue that even if they breached their duty to surrender under section 521(a) (2), the only remedy available to the bankruptcy court was to lift the automatic stay for Citibank, which would allow Citibank to foreclose on the house in the ordinary course. Citibank asked us to strike this portion of the Faillas' briefs in their May 25 motion to strike, which was carried with the case. The Faillas concede that they did not raise this argument below. They ask us to excuse their forfeiture because their argument is an important, unsettled question of law. This argument is not forfeited, but fails on the merits, rendering Citibank's motion to strike moot.

[16] The Faillas' new argument falls within exceptions to the general rule that a circuit court will not consider an issue not raised in the district court. See Access Now, Inc. v. Sw. Airlines Co., 385 F.3d 1324, 1332 (11th Cir. 2004) (quoting Wright v. Hanna Steel Corp., 270 F.3d 1336, 1342 (11th Cir. 2001)). It is a "pure question of law" and its "proper resolution is beyond any doubt." Id. Moreover, the Faillas' argument is intertwined with their other arguments. For instance, part of the reason the Faillas contend the bankruptcy court cannot order them to stop opposing the foreclosure action is that section 521(a)(2) *1179 is merely a "notice statute" that does not affect substantive property rights.

[17] [19] On the merits, however, bankruptcy courts are not limited to lifting the automatic stay. Bankruptcy courts have broad powers to remedy violations of the mandatory duties section 521(a)(2) imposes on debtors. See Taylor, 3 F.3d at 1516. Section 105(a) states that bankruptcy courts can "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title," 11 U.S.C. § 105(a), which includes section 521(a)(2). Bankruptcy judges also have "broad authority ... to take any action that is necessary or appropriate 'to prevent an abuse of process.' " Marrama v. Citizens Bank of Mass., 549 U.S. 365, 375, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007) (quoting 11 U.S.C. § 105(a)). A debtor who promises to surrender property in bankruptcy court and then, once his debts are discharged, breaks that promise by opposing a foreclosure action in state court has abused the bankruptcy process. See Guerra, 544 B.R. at 710.

[20] If a bankruptcy court could only lift the automatic stay, then debtors could violate section 521(a)(2) with impunity. The automatic stay is *always* lifted at the end of the bankruptcy proceedings, *see* 2 Bankruptcy Law Manual § 10:7 (5th ed.), so this remedy does nothing to punish debtors who lie to the bankruptcy court about their intent to surrender property. While a creditor may be able to invoke the doctrine of judicial estoppel in state court to force debtors to keep a promise made in bankruptcy court, its availability does not affect the statutory authority of bankruptcy judges to remedy abuses that occur in *their* courts. And there is nothing strange about bankruptcy judges entering orders that command a party to do something in a nonbankruptcy proceeding. Bankruptcy courts "regularly exercise jurisdiction to tell parties what

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they can or cannot do in a non-bankruptcy forum." *In re Lapeyre*, 544 B.R. 719, 723 (Bankr. S.D. Fla. 2016). Just as the bankruptcy court may "order [] creditors who violate the automatic stay to take corrective action in the non-bankruptcy litigation," the bankruptcy court may "order the Debtors to withdraw their affirmative defenses and dismiss their counterclaim in the Foreclosure Case." *Id.* The bankruptcy court had the authority to compel the Faillas to fulfill their mandatory duty under section 521(a) (2) not to oppose the foreclosure action in state court.

IV. CONCLUSION

We **AFFIRM** the order compelling the Faillas to surrender their home to Citibank. We **DENY AS MOOT** the motion to strike.

All Citations

838 F.3d 1170, 76 Collier Bankr.Cas.2d 602, 63 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 83,020, 26 Fla. L. Weekly Fed. C 869

Footnotes

* Honorable Roger H. Lawson, Jr., United States District Judge for the Middle District of Georgia, sitting by designation.

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In re Ayala, 568 B.R. 870 (2017)

568 B.R. 870 United States Bankruptcy Court, M.D. Florida, ORLANDO DIVISION.

IN RE Jose U. AYALA and Ana L. Ayala, Debtors.

Case No. 6:11-bk-15964-RAC | | Signed April 17, 2017

Synopsis

Background: Mortgagee moved to reopen closed Chapter 7 case in order to enforce debtor-mortgagors' stated decision to "surrender" mortgage property.

[Holding:] The Bankruptcy Court, Roberta A. Colton, J., held that "cause" did not exist to reopen a Chapter 7 case that had been closed years earlier, in order to permit mortgagee which had not declared a default or sought to foreclose until well after the case was closed, and which had accepted at least some of the postbankruptcy payments made by debtor-mortgagors, to enforce debtors' stated intent to "surrender" mortgage property.

Motion denied.

West Headnotes (4)

[1] Bankruptcy

Grounds and Objections

"Cause" did not exist to reopen a Chapter 7 case that had been closed years earlier, in order to permit mortgagee which had not declared a default or sought to foreclose until well after the case was closed, and which had accepted at least some of the postbankruptcy payments made by debtor-mortgagors, to enforce debtors' stated intent to "surrender" mortgage property by barring debtors from defending state court foreclosure action by contesting whether mortgage was in fact in default; there was no reason to reopen case years after it had been closed, and after

mortgagee had at least arguably waived its right to enforce debtors' statement of their intent to surrender, to prevent issue of whether there had in fact been a default from being litigated in state court. 11 U.S.C.A. § 350(b).

Cases that cite this headnote

[2] Bankruptcy



Whether "other cause" exists to reopen a closed bankruptcy case is left to discretion of bankruptcy court. 11 U.S.C.A. § 350(b).

Cases that cite this headnote

[3] Bankruptcy

Grounds and Objections

In ruling on motion to reopen a closed case, bankruptcy court's focus should be on the substance and equitable factors of individual case. 11 U.S.C.A. § 350(b).

Cases that cite this headnote

[4] Bankruptcy

Carrying out provisions of Code

Discretionary authority that bankruptcy court possesses under statute authorizing it to issue "necessary or appropriate" orders is broad. 11 U.S.C.A. § 105(a).

Cases that cite this headnote

Attorneys and Law Firms

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ORDER DENYING SPACE COAST
CREDIT UNION'S MOTION TO REOPEN
CHAPTER 7 CASE AND TO COMPEL
SURRENDER OF MORTGAGED PROPERTY

Roberta A. Colton, United States Bankruptcy Judge

1

In re Ayala, 568 B.R. 870 (2017)

Space Coast Credit Union ("Space Coast") filed a Motion to Reopen Chapter 7 Case and to Compel Surrender of Mortgage Property (the "Motion"). (Doc. 23). Debtors filed a response (Doc. 31), and oral argument was presented on April 6, 2017.

The issue presented is whether this 2011 case should be reopened to prevent the former debtors from contesting a foreclosure because they "surrendered" the underlying property in their long-closed chapter 7 case. Because the facts here are significantly different from those in *In re Failla*, ¹ the request to reopen this case is denied.

Background

Without the assistance of counsel, Jose and Ana Ayala filed a chapter 7 petition on October 21, 2011. ² They properly listed their home and the Space Coast mortgage on their bankruptcy schedules. Later, they filed a "Chapter 7 Individual Debtor's Statement of Intentions," declaring that the property would be "surrendered." ³ The Ayalas received a bankruptcy discharge on February 1, 2012. ⁴

For more than two and a half years after the bankruptcy case was closed, the Ayalas did nothing to prevent Space Coast from obtaining possession of their home. In fact, the Ayalas assert that they continued making mortgage payments to Space Coast during this time. Space Coast acknowledges that some payments were made and accepted, but the parties continue to dispute whether there was a legal default under the loan, as modified. ⁵

Nevertheless, Space Coast filed a foreclosure action on October 16, 2014. Although the Ayalas initially did not contest the foreclosure, ⁶ they eventually retained counsel to defend, principally on grounds that the loan, as modified, is not in default. The state court handling the foreclosure recently tried the question of whether the Ayalas defaulted, but has yet to issue its ruling. ⁷

*872 After the state court trial, and after the Eleventh Circuit's decision in *Failla*, Space Coast moves to reopen the Ayalas' old bankruptcy case to compel the Ayalas to honor their 2011 Statement of Intentions and "surrender" the mortgaged property. 8 Space Coast further requests

an order preventing the Ayalas from contesting the foreclosure in any way, including asserting that a default had not occurred. ⁹ The Ayalas respond that the bankruptcy case should remain closed and the state court permitted to rule on the "default" issue. ¹⁰ Alternatively, the Ayalas request leave to amend their Statement of Intentions to change the "surrender" designation that they made without the assistance of counsel. ¹¹

Analysis

[1] Once closed, a "case may be reopened ... to administer assets, to accord relief to the debtor, or for other cause." 11 U.S.C. § 350(b). 12 "[O]ther cause" is not defined in the bankruptcy code. 13 Here the articulated "cause" is enforcement of the Ayalas' statement of intent to surrender the property mortgaged to Space Coast, premised on the Eleventh Circuit's recent decision in *Failla*.

[2] [3] Whether "other cause" exists to reopen a case is left to the discretion of the bankruptcy court. ¹⁴ In making this determination, the court's focus should be on the substance and equitable factors of the individual case. ¹⁵

In *Failla*, the Eleventh Circuit affirmed a bankruptcy court order under section 105(a) of the Bankruptcy Code ¹⁶ enjoining the debtors from defending or opposing a foreclosure and sale. ¹⁷ The Faillas had "surrendered" their property in their statement of intentions filed pursuant to section 521(a)(2). ¹⁸ Nevertheless, during and following their bankruptcy, the Faillas continued to live in the home and fight the foreclosure, even asserting affirmative defenses. ¹⁹ There is no suggestion that the Faillas made any post-bankruptcy payments to their lender or that their defenses were based on any post-bankruptcy activities of their lender. In fact, the foreclosure action was filed against the Faillas two years before they filed their chapter 7 petition. ²⁰

[4] *873 The Eleventh Circuit made two important rulings. First, by stating their intent to "surrender" the property under section 521(a)(2), the debtors were required to drop any opposition to the pending foreclosure action. ²¹ Second, the bankruptcy court had

the authority under section 105(a) to order the debtors to withdraw their defenses and cease any opposition to the pending state court foreclosure action. ²²

The order affirmed in *Failla* was designed to remedy a perceived abuse of the bankruptcy laws. ²³ The Faillas claimed all of the benefits of bankruptcy and yet continued to contest the pending foreclosure on all fronts. ²⁴ Presumably, the Faillas continued to live on the property without making any payments to the lender.

Nothing before the court suggests any such abuse by the Ayalas. When the Ayalas filed their chapter 7 petition, no foreclosure was pending. Indeed, nothing in the record suggests that they were in even in default of the Space Coast loan. ²⁵ Space Coast certainly did not seek relief from the automatic stay in the chapter 7 case or seek to compel surrender of the property while the chapter 7 was open. Without the assistance of counsel, and under the circumstances, it is also unclear whether the Ayalas appreciated the legal significance of their "surrender" designation. But even if they did, they could hardly have foreseen the Eleventh Circuit's decision in *Failla*, almost five years after signing their Statement of Intentions.

For more than two and a half years after the bankruptcy case was closed, the Ayalas did nothing to prevent Space Coast from foreclosing on the property. To the contrary, they made payments on the mortgage, at least some of which Space Coast admits were accepted. Now, more than five years after the Ayalas stated their intent to "surrender" the property, Space Coast seeks to reopen this case to enforce the "surrender."

So what are the limits of *Failla*, if any? Admittedly, the Eleventh Circuit's opinion includes sweeping language, without any acknowledged limitations. But consider this —after a "surrender" under section 521(a)(2), can a lender accept payments for 30 years and then prevent the debtor from arguing that the note and mortgage were satisfied? Can a lender wait 10 years to foreclose and then prevent the debtor from raising a statute of limitations defense? Does it matter that the "default" at issue here is not an affirmative defense but a component of the lender's burden of proof in the foreclosure? Does *Failla* require a debtor to stand silent if a lender presents a false affidavit to the state court? These issues were explored extensively at oral argument without satisfactory resolution.

In the end, common sense must dictate *Failla*'s application to the particular facts of different cases. The Eleventh Circuit dealt with the facts presented to it and *874 concluded that the bankruptcy court's order remedying the perceived abuse was authorized under section 105(a). *Failla* does not state that similar orders (under the discretionary provision of section 105(a)) are now mandatory. And certainly not all foreclosure defenses after the conclusion of a bankruptcy case reflect abuse of bankruptcy process. ²⁶ *Failla* should not be viewed as *carte blanche* for post-bankruptcy lender misconduct. Instead, each case must be evaluated on its own facts, and careful consideration should be exercised before issuing any order that impacts pending state court proceedings.

Here it is at least arguable that post-bankruptcy conduct by Space Coast may have resulted in a waiver of the Ayalas' 2011 "surrender." Whether such a waiver has actually occurred is not for me decide in a bankruptcy case that has been closed for five years. It is also not for me to prevent the state court from deciding this issue after a trial has already taken place. I simply cannot conclude that the Ayalas' post-bankruptcy conduct evidences the same "abuse of process" illustrated in *Failla*.

Conclusion

Based on the forgoing analysis, the court finds that the equities do not favor Space Coast and that "cause" does not exist to reopen this case.

Accordingly, it is **ORDERED** that Space Coast's Motion to Reopen Chapter 7 Case and to Compel Surrender of Mortgage Property is **DENIED**, and the remaining requests for relief in the Motion are **DENIED** as moot.

Attorney Michael C. Caborn directed to serve a copy of this order on interested parties who are non-CM/ECF users and file a certificate of service within 3 days.

ORDERED.

All Citations

568 B.R. 870

In re Ayala, 568 B.R. 870 (2017)

Footnotes

- 1 Failla v. Citibank, N.A. (In re Failla), 838 F.3d 1170 (11th Cir. 2016).
- 2 Doc. 1.
- 3 Doc. 8 (hereafter, "Statement of Intentions").
- 4 Doc. 19.
- In its Motion, Space Coast alleges that the Ayalas' are in "default," but is careful not to state when the alleged default occurred. (Doc. 23, ¶ 8).
- 6 Doc. 23, Ex. H.
- 7 Id.
- 8 Doc. 23.
- 9 *Id.*
- 10 Doc. 31.
- 11 *Id.*
- 12 A motion to reopen may be filed by a party in interest such as Space Coast. Fed. R. Bankr. P. 5010.
- 13 In re Shondel, 950 F.2d 1301, 1304 (7th Cir. 1991).
- 14 Id.; see also Jester v. Wells Fargo Bank N.A. (In re Jester), 656 Fed.Appx. 425, 427–28 (10th Cir. 2016); Zinchiak v. CIT Small Business Lending Corp. (In re Zinchiak), 406 F.3d 214, 223 (3d Cir. 2005); Curry v. Castillo (In re Castillo), 297 F.3d 940, 944 (9th Cir. 2002).
- 15 In re Shondel, 950 F.2d at 1304.
- 16 11 U.S.C. §§ 101–1532 ("Code" or "Bankruptcy Code"). Unless otherwise indicated, all sectional references are to the Bankruptcy Code.
- 17 In re Failla, 838 F.3d at 1179.
- Section 521(a)(2) requires chapter 7 debtors with secured obligations to file a statement of intentions with respect to the "retention or surrender of such property" The statement must be filed within 30 days of the chapter 7 petition, and the debtors must perform their intention within 30 days after the first date set for the meeting of creditors under section 341(a).
- 19 In re Failla, 529 B.R. 786, 787–88 (Bankr. S.D. Fla. 2014).
- 20 *Id.*
- 21 In re Failla, 838 F.3d at 1176.
- 22 Id. at 1179. Section 105(a) provides that the bankruptcy court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." Id. (emphasis added). The court's discretionary authority under section 105(a) is "broad." Failla, 838 F.3d at 1179 (quoting Marrama v. Citizens Bank of Mass., 549 U.S. 365, 375, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007)).
- 23 *Id.* at 1178–79.
- 24 In re Failla, 529 B.R. at 787–88.
- On their Statement of Financial Affairs, the Ayalas disclosed a sizeable payment to Space Coast made shortly before the bankruptcy petition was filed. The payment appears to constitute three monthly payments when compared to the Schedule J.
- In *In re Guerra*, 544 B.R. 707, 711 (Bankr. M.D. Fla. 2016), a case cited favorably in *Failla*, the court actually concluded its analysis as follows:

Here, years passed between the time the Debtor swore she would surrender her home and the first time she opposed the state court foreclosure action. Given that intervening lapse of time, the Court cannot conclude the Debtor intended to perpetrate a fraud on this Court or make a mockery of the bankruptcy system. Perhaps circumstances have since changed that would allow the Debtor to make the required mortgage payments. ... [W]hether judicial estoppel precludes the Debtor from defending the foreclosure action based on her inconsistent statements should, under the facts of this case, be left to the state court.

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Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

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Development, LLC v. Malloy, 2nd Cir.(Conn.), June 21, 2017

137 S.Ct. 973

Supreme Court of the United States

Casimir CZYZEWSKI, et al., Petitioners

v. JEVIC HOLDING CORP., et al.

> No. 15–649. | Argued Dec. 7, 2016. | Decided March 22, 2017.

Synopsis

Background: Order was entered by the United States Bankruptcy Court for the District of Delaware, approving settlement that resulted in structured dismissal of Chapter 11 case, and former employees of debtor appealed. The District Court, Sue L. Robinson, J., 2014 WL 268613, affirmed, and former employees appealed. The Third Circuit Court of Appeals, Hardiman, Circuit Judge, 787 F.3d 173, affirmed. Certiorari was granted.

Holdings: The Supreme Court, Justice Breyer, held that:

- [1] former employees had Article III standing, and
- [2] a bankruptcy court may not approve a structured dismissal of a Chapter 11 case that provides for distributions that do not follow the Bankruptcy Code's ordinary priority rules without the affected creditors' consent.

Reversed and remanded.

Justice Thomas filed a dissenting opinion in which Justice Alito joined.

West Headnotes (21)

[1] Bankruptcy

Types of cases

Business may file for bankruptcy under either Chapter 7 or Chapter 11 of the Bankruptcy Code.

1 Cases that cite this headnote

[2] Bankruptcy

- Liquidation, Distribution, and Closing

In a Chapter 7 case, a trustee liquidates the debtor's assets and distributes them to creditors.

2 Cases that cite this headnote

[3] Bankruptcy

In general;nature and purpose

In a Chapter 11 case, debtor and creditors try to negotiate a plan that will govern the distribution of valuable assets from the debtor's estate and often keep the business operating as a going concern. 11 U.S.C.A. §§ 1121, 1123, 1129, 1141.

3 Cases that cite this headnote

[4] Bankruptcy

Creation of estate; time

Bankruptcy

interest of debtor in general

Upon filing a Chapter 11 petition, an estate is created comprising all property of the debtor. 11 U.S.C.A. § 541(a)(1).

Cases that cite this headnote

[5] Bankruptcy

Debtor in possession

Bankruptcy

Debtor in possession, in general

After a Chapter 11 petition is filed, a fiduciary, often the debtor's existing management team, is installed to manage the estate in the interest of the creditors; acting as "debtor in possession," this fiduciary may operate the business and perform certain bankruptcy-related functions, such as seeking to recover

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for the estate preferential or fraudulent transfers made to other persons. 11 U.S.C.A. §§ 363(c)(1), 547, 548, 1106–1108.

1 Cases that cite this headnote

[6] Bankruptcy

Notice to creditors; commencement

Bankruptcy

Proceedings, Acts, or Persons Affected

Upon the filing of a Chapter 11 petition, an "automatic stay" of all collection proceedings against the debtor takes effect. 11 U.S.C.A. § 362(a).

Cases that cite this headnote

[7] Bankruptcy

Confirmation; Objections

Bankruptcy

In General; Grounds in General

Chapter 11 foresees three possible outcomes: confirmation of a court-approved plan that may keep the business operating while helping creditors by providing for payments, conversion of the case to Chapter 7 for liquidation of the business and distribution of its assets, or dismissal of the Chapter 11 case. 11 U.S.C.A. §§ 726, 1112(a, b), 1123, 1129, 1141.

Cases that cite this headnote

[8] Bankruptcy

Effect;proceedings in converted case

Dismissal of a Chapter 11 case typically revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case; in other words, it aims to return to the prepetition financial status quo. 11 U.S.C.A. § 349(b)(3).

2 Cases that cite this headnote

[9] Bankruptcy

Judicial authority or approval

Bankruptcy

Effect; proceedings in converted case

Recognizing that conditions may have changed in ways that make a perfect restoration of the status quo difficult or impossible, the Bankruptcy Code permits the bankruptcy court, for cause, to alter a Chapter 11 dismissal's ordinary restorative consequences, so as to provide for a structured dismissal. 11 U.S.C.A. § 349(b).

1 Cases that cite this headnote

[10] Bankruptcy

Compromises, Releases, and Stipulations

Bankruptcy

Effect;proceedings in converted case

"Structured dismissal" is a dismissal of a Chapter 11 case that alters a dismissal's ordinary consequences of restoration of the prepetition financial status quo, or which has other special conditions attached. 11 U.S.C.A. § 349(b).

2 Cases that cite this headnote

[11] Bankruptcy

Priorities

Bankruptcy Code sets forth a basic system of priority, which ordinarily determines the order in which the bankruptcy court will distribute assets of the estate: secured creditors are highest on the priority list, for they must receive the proceeds of the collateral that secures their debts, special classes of creditors, such as those who hold certain claims for taxes or wages, come next in a listed order, followed by low-priority creditors, including general unsecured creditors, and then equity holders, who receive nothing until all previously listed creditors have been paid in full. 11 U.S.C.A. §§ 507, 725, 726.

Cases that cite this headnote

[12] Bankruptcy

Order of distribution

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Distributions of assets in a Chapter 7 liquidation must follow the order prescribed by the Bankruptcy Code. 11 U.S.C.A. §§ 725, 726.

Cases that cite this headnote

[13] Bankruptcy

Preservation of priority

Although, with the consent of affected parties, Chapter 11 plans may impose a different ordering of distributions than that set forth in the Bankruptcy Code's priority scheme, a bankruptcy court cannot confirm a plan that contains priority-violating distributions over the objection of an impaired creditor class. 11 U.S.C.A. § 1129(a)(7), (b)(2).

3 Cases that cite this headnote

[14] Corporations and Business Organizations

Sale or Transfer of All or Controlling Interest of Stock

In a "leveraged buyout," the buyer (B) typically borrows from a third party (T) a large share of the funds needed to purchase a company (C), and B then pays the money to C's shareholders; having bought the stock, B owns C, and B then pledges C's assets to T so that T will have security for its loan.

1 Cases that cite this headnote

[15] Labor and Employment

Fime Time

Federal Worker Adjustment and Retraining Notification (WARN) Act and similar New Jersey act require a company to give workers at least 60 days' notice before their termination. Worker Adjustment and Retraining Notification Act, § 3, 29 U.S.C.A. § 2102; N.J.S.A. 34:21–2.

Cases that cite this headnote

[16] Bankruptcy

Employees' Claims

That portion of former employees' judgment against Chapter 11 debtor that counted as a priority wage claim was entitled to payment ahead of general unsecured claims against the estate. 11 U.S.C.A. § 507(a)(4).

Cases that cite this headnote

[17] Bankruptcy

Right of review and persons entitled; parties; waiver or estoppel

Chapter 11 debtor's former employees, who held priority wage claims against debtor by virtue of their WARN Act judgment against it, had Article III standing to challenge bankruptcy court's approval of settlement agreement that settled fraudulentconveyance proceeding and resulted in structured dismissal of case, and that provided that former employees would receive nothing on their WARN claims but lower-priority general unsecured creditors would be paid; former employees suffered a loss, in that, as a consequence of bankruptcy court's approval of structured dismissal, they lost chance to obtain a settlement that respected their priorities or, if not that, the power to assert the fraudulent-conveyance claim themselves, and a decision in former employees' favor was likely to redress that loss. U.S.C.A. Const. Art. 3, § 1 et seq.; 11 U.S.C.A. § 507; Worker Adjustment and Retraining Notification Act, § 3, 29 U.S.C.A. § 2102.

1 Cases that cite this headnote

[18] Federal Civil Procedure

► In general; injury or interest

For standing purposes, a loss of even a small amount of money is ordinarily an "injury." U.S.C.A. Const. Art. 3, § 1 et seq.

5 Cases that cite this headnote

[19] Bankruptcy

Judicial authority or approval

Bankruptcy

Effect; proceedings in converted case

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Bankruptcy court may not approve a structured dismissal of a Chapter 11 case that provides for distributions that do not follow the Bankruptcy Code's ordinary priority rules without the affected creditors' consent.

4 Cases that cite this headnote

[20] Bankruptcy

Order of distribution

In Chapter 7 liquidations, priority is an absolute command; lower priority creditors cannot receive anything until higher priority creditors have been paid in full. 11 U.S.C.A. §§ 725, 726.

Cases that cite this headnote

[21] Bankruptcy

Priorities

Courts cannot alter the balance struck by the Bankruptcy Code's priority provisions, not even in "rare cases."

Cases that cite this headnote

*975 Syllabus *

There are three possible conclusions to a Chapter 11 bankruptcy. First, debtor and creditors may negotiate a plan to govern the distribution of the estate's value. See, e.g., 11 U.S.C. §§ 1121, 1123, 1129, 1141. Second, the bankruptcy court may convert the case to Chapter 7 for liquidation of the business and distribution of its assets to creditors. §§ 1112(a), (b), 726. Finally, the bankruptcy court may dismiss the case. § 1112(b). A court ordering a *976 dismissal ordinarily attempts to restore the prepetition financial status quo. § 349(b)(3). Yet if perfect restoration proves difficult or impossible, the court may, "for cause," alter the dismissal's normal restorative consequences, § 349(b)—i.e., it may order a "structured dismissal." The Bankruptcy Code also establishes basic priority rules for determining the order in which the court will distribute an estate's assets. The Code makes clear that distributions in a Chapter 7 liquidation must follow this prescribed order. §§ 725, 726. Chapter 11 permits some flexibility, but a court still cannot confirm a plan that contains priority-violating distributions over the objection of an impaired creditor class. §§ 1129(a)(7), (b)(2). The Code does not explicitly state what priority rules—if any—apply to the distribution of assets in a structured dismissal.

Respondent Jevic Transportation filed for Chapter 11 bankruptcy after being purchased in a leveraged buyout. The bankruptcy prompted two lawsuits. In the first, a group of former Jevic truckdrivers, petitioners here, was awarded a judgment against Jevic for Jevic's failure to provide proper notice of termination in violation of state and federal Worker Adjustment and Retraining Notification (WARN) Acts. Part of that judgment counted as a priority wage claim under § 507(a)(4), entitling the workers to payment ahead of general unsecured claims against the Jevic estate. In the second suit, a court-authorized committee representing Jevic's unsecured creditors sued Sun Capital and CIT Group, respondents here, for fraudulent conveyance in connection with the leveraged buyout of Jevic. These parties negotiated a settlement agreement that called for a structured dismissal of Jevic's Chapter 11 bankruptcy. Under the proposed structured dismissal, petitioners would receive nothing on their WARN claims, but lower-priority general unsecured creditors would be paid. Petitioners argued that the distribution scheme accordingly violated the Code's priority rules by paying general unsecured claims ahead of their own. The Bankruptcy Court nevertheless approved the settlement agreement and dismissed the case, reasoning that because the proposed payouts would occur pursuant to a structured dismissal rather than an approved plan, the failure to follow ordinary priority rules did not bar approval. The District Court and the Third Circuit affirmed.

Held:

1. Petitioners have Article III standing. Respondents argue that petitioners have not "suffered an injury in fact," or at least one "likely to be redressed by a favorable judicial decision," *Spokeo, Inc. v. Robins,* 578 U.S. —, —, 136 S.Ct. 1540, 1547, 194 L.Ed.2d 635 because petitioners would have gotten nothing even if the Bankruptcy Court had never approved the structured dismissal and will still get nothing if the structured dismissal is undone now. That argument rests

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upon the assumptions that (1) without a violation of ordinary priority rules, there will be no settlement, and (2) without a settlement, the fraudulent-conveyance lawsuit has no value. The record, however, indicates both that a settlement that respects ordinary priorities remains a reasonable possibility and that the fraudulent-conveyance claim could have litigation value. Therefore, as a consequence of the Bankruptcy Court's approval of the structured dismissal, petitioners lost a chance to obtain a settlement that respected their priorities or, if not that, the power to assert the fraudulent-conveyance claim themselves. A decision in their favor is likely to redress that loss. Pp. 982 – 983.

2. Bankruptcy courts may not approve structured dismissals that provide for distributions that do not follow ordinary *977 priority rules without the consent of affected creditors. Pp. 983 – 987.

(a) Given the importance of the priority system, this Court looks for an affirmative indication of intent before concluding that Congress means to make a major departure. See Whitman v. American Trucking Assns., Inc., 531 U.S. 457, 468, 121 S.Ct. 903, 149 L.Ed.2d 1. Nothing in the statute evinces such intent. Insofar as the dismissal sections of Chapter 11 foresee any transfer of assets, they seek a restoration of the prepetition financial status quo. Read in context, § 349(b), which permits a bankruptcy judge, "for cause, [to] orde[r] otherwise," seems designed to give courts the flexibility to protect reliance interests acquired in the bankruptcy, not to make general end-of-case distributions that would be flatly impermissible in a Chapter 11 plan or Chapter 7 liquidation. Precedent does not support a contrary position. E.g., In re Iridium Operating LLC, 478 F.3d 452 (C.A.2), distinguished. Cases in which courts have approved deviations from ordinary priority rules generally involve interim distributions serving significant Code-related objectives. That is not the case here, where, e.g., the priority-violating distribution is attached to a final disposition, does not preserve the debtor as a going concern, does not make the disfavored creditors better off, does not promote the possibility of a confirmable plan, does not help to restore the status quo ante, and does not protect reliance interests. Pp. 983 – 986.

(b) Congress did not authorize a "rare case" exception that permits courts to disregard priority in structured dismissals for "sufficient reasons." The fact that it is difficult to give precise content to the concept of "sufficient reasons" threatens to turn the court below's exception into a more general rule, resulting in uncertainty that has potentially serious consequences —e.g., departure from the protections granted particular classes of creditors, changes in the bargaining power of different classes of creditors even in bankruptcies that do not end in structured dismissals, risks of collusion, and increased difficulty in achieving settlements. Courts cannot deviate from the strictures of the Code, even in "rare cases." Pp. 986 – 987.

787 F.3d 173, reversed and remanded.

BREYER, J., delivered the opinion of the Court, in which ROBERTS, C.J., and KENNEDY, GINSBURG, SOTOMAYOR, and KAGAN, JJ., joined. THOMAS, J., filed a dissenting opinion, in which ALITO, J., joined.

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Opinion

Justice BREYER delivered the opinion of the Court.

Bankruptcy Code Chapter 11 allows debtors and their creditors to negotiate a plan for dividing an estate's value. See 11 U.S.C. §§ 1123, 1129, 1141. But sometimes the parties cannot agree on a plan. If so, the bankruptcy court may decide to dismiss the case. § 1112(b). The Code then ordinarily provides for what is, in effect, a restoration of the prepetition financial status quo. § 349(b).

In the case before us, a Bankruptcy Court dismissed a Chapter 11 bankruptcy. But the court did not simply restore the prepetition status quo. Instead, the court ordered a distribution of estate assets that gave money to high-priority secured creditors and to low-priority general unsecured creditors but which skipped certain dissenting mid-priority creditors. The skipped creditors would have been entitled to payment ahead of the general unsecured creditors in a Chapter 11 plan (or in a Chapter 7 liquidation). See §§ 507, 725, 726, 1129. The question before us is whether a bankruptcy court has the legal power to order this priority-skipping kind of distribution scheme in connection with a Chapter 11 dismissal.

In our view, a bankruptcy court does not have such a power. A distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distributions of estate value in business bankruptcies.

I

Α

1

[1] [2] [3] We begin with a few fundamentals: A business may file for bankruptcy under either Chapter 7 or Chapter 11. In Chapter 7, a trustee liquidates the debtor's assets and distributes them to creditors. See § 701 *et seq.* In Chapter 11, debtor and creditors try to negotiate a plan that will govern the distribution of valuable assets from the debtor's estate and often keep the business operating as a going concern. See, *e.g.*, §§ 1121, 1123, 1129, 1141 (setting out the framework in which the parties negotiate).

[4] [5] [6] Filing for Chapter 11 bankruptcy has several relevant legal consequences. First, an estate is created comprising all property of the debtor. § 541(a)(1). Second, a fiduciary is installed to manage the estate in the interest of the creditors. §§ 1106, 1107(a). This fiduciary, often the debtor's existing management team, acts as "debtor in possession." §§ 1101(1), 1104. It may operate the business, §§ 363(c)(1), 1108, and perform certain bankruptcy-related functions, such as seeking to recover for the estate preferential or fraudulent transfers made to other persons, § 547 (transfers made before bankruptcy that unfairly preferred particular creditors); § 548 (fraudulent transfers, including transfers made before bankruptcy for which the debtor did not receive fair value). *979 Third, an "automatic stay" of all collection proceedings against the debtor takes effect. § 362(a).

[8] It is important to keep in mind that Chapter [7] 11 foresees three possible outcomes. The first is a bankruptcy-court-confirmed plan. Such a plan may keep the business operating but, at the same time, help creditors by providing for payments, perhaps over time. See \\$\ 1123, 1129, 1141. The second possible outcome is conversion of the case to a Chapter 7 proceeding for liquidation of the business and a distribution of its remaining assets. §§ 1112(a), (b), 726. That conversion in effect confesses an inability to find a plan. The third possible outcome is dismissal of the Chapter 11 case. § 1112(b). A dismissal typically "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case"—in other words, it aims to return to the prepetition financial status quo. § 349(b)(3).

[9] [10] Nonetheless, recognizing that conditions may have changed in ways that make a perfect restoration of the status quo difficult or impossible, the Code permits the bankruptcy court, "for cause," to alter a Chapter 11 dismissal's ordinary restorative consequences. § 349(b). A dismissal that does so (or which has other special

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conditions attached) is often referred to as a "structured dismissal," defined by the American Bankruptcy Institute as a

"hybrid dismissal and confirmation order ... that ... typically dismisses the case while, among other things, approving certain distributions to creditors, granting certain third-party releases, enjoining certain conduct by creditors, and not necessarily vacating orders or unwinding transactions undertaken during the case." American Bankruptcy Institute Commission To Study the Reform of Chapter 11, 2012–2014 Final Report and Recommendations 270 (2014).

Although the Code does not expressly mention structured dismissals, they "appear to be increasingly common." *Ibid.*, n. 973.

2

[11] The Code also sets forth a basic system of priority, which ordinarily determines the order in which the bankruptcy court will distribute assets of the estate. Secured creditors are highest on the priority list, for they must receive the proceeds of the collateral that secures their debts. 11 U.S.C. § 725. Special classes of creditors, such as those who hold certain claims for taxes or wages, come next in a listed order. §§ 507, 726(a)(1). Then come low-priority creditors, including general unsecured creditors. § 726(a)(2). The Code places equity holders at the bottom of the priority list. They receive nothing until all previously listed creditors have been paid in full. § 726(a)(6).

[12] [13] The Code makes clear that distributions of assets in a Chapter 7 liquidation must follow this prescribed order. §§ 725, 726. It provides somewhat more flexibility for distributions pursuant to Chapter 11 plans, which may impose a different ordering with the consent of the affected parties. But a bankruptcy court cannot confirm a plan that contains priority-violating distributions over the objection of an impaired creditor class. §§ 1129(a)(7), 1129(b)(2).

The question here concerns the interplay between the Code's priority rules and a Chapter 11 dismissal. Here, the Bankruptcy Court neither liquidated the debtor under Chapter 7 nor confirmed a Chapter 11 plan. But the court, instead of reverting to the prebankruptcy status

quo, ordered *980 a distribution of the estate assets to creditors by attaching conditions to the dismissal (*i.e.*, it ordered a structured dismissal). The Code does not explicitly state what priority rules—if any—apply to a distribution in these circumstances. May a court consequently provide for distributions that deviate from the ordinary priority rules that would apply to a Chapter 7 liquidation or a Chapter 11 plan? Can it approve conditions that give estate assets to members of a lower priority class while skipping objecting members of a higher priority class?

В

[14] In 2006, Sun Capital Partners, a private equity firm, acquired Jevic Transportation Corporation with money borrowed from CIT Group in a "leveraged buyout." In a leveraged buyout, the buyer (B) typically borrows from a third party (T) a large share of the funds needed to purchase a company (C). B then pays the money to C's shareholders. Having bought the stock, B owns C. B then pledges C's assets to T so that T will have security for its loan. Thus, if the selling price for C is \$50 million, B might use \$10 million of its own money, borrow \$40 million from T, pay \$50 million to C's shareholders, and then pledge C assets worth \$40 million (or more) to T as security for T's \$40 million loan. If B manages C well, it might make enough money to pay T back the \$40 million and earn a handsome profit on its own \$10 million investment. But, if the deal sours and C descends into bankruptcy, beware of what might happen: Instead of C's \$40 million in assets being distributed to its existing creditors, the money will go to T to pay back T's loan—the loan that allowed B to buy C. (T will receive what remains of C's assets because T is now a secured creditor, putting it at the top of the priority list). Since C's shareholders receive money while C's creditors lose their claim to C's remaining assets, unsuccessful leveraged buyouts often lead to fraudulent conveyance suits alleging that the purchaser (B) transferred the company's assets without receiving fair value in return. See Lipson & Vandermeuse, Stern, Seriously: The Article I Judicial Power, Fraudulent Transfers, and Leveraged Buyouts, 2013 Wis. L.Rev. 1161, 1220–1221.

This is precisely what happened here. Just two years after Sun's buyout, Jevic (C in our leveraged buyout example) filed for Chapter 11 bankruptcy. At the time of filing, it

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owed \$53 million to senior secured creditors Sun and CIT (B and T in our example), and over \$20 million to tax and general unsecured creditors.

The circumstances surrounding Jevic's [15] [16] bankruptcy led to two lawsuits. First, petitioners, a group of former Jevic truckdrivers, filed suit in bankruptcy court against Jevic and Sun. Petitioners pointed out that, just before entering bankruptcy, Jevic had halted almost all its operations and had told petitioners that they would be fired. Petitioners claimed that Jevic and Sun had thereby violated state and federal Worker Adjustment and Retraining Notification (WARN) Acts—laws that require a company to give workers at least 60 days' notice before their termination. See 29 U.S.C. § 2102; N.J. Stat. Ann. § 34:21–2 (West 2011). The Bankruptcy Court granted summary judgment for petitioners against Jevic, leaving them (and this is the point to remember) with a judgment that petitioners say is worth \$12.4 million. See *In re Jevic* Holding Corp., 496 B.R. 151 (Bkrtcy.Ct.D.Del.2013). Some \$8.3 million of that judgment counts as a priority wage claim under 11 U.S.C. § 507(a)(4), and is therefore entitled to payment ahead of general unsecured claims against the Jevic estate.

*981 Petitioners' WARN suit against Sun continued throughout most of the litigation now before us. But eventually Sun prevailed on the ground that Sun was not the workers' employer at the relevant times. See *In re Jevic Holding Corp.*, 656 Fed.Appx. 617 (C.A.3 2016).

Second, the Bankruptcy Court authorized a committee representing Jevic's unsecured creditors to sue Sun and CIT. The Bankruptcy Court and the parties were aware that any proceeds from such a suit would belong not to the unsecured creditors, but to the bankruptcy estate. See §§ 541(a)(1), (6); Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 552-553 (C.A.3 2003) (en banc) (holding that a creditor's committee can bring a derivative action on behalf of the estate). The committee alleged that Sun and CIT, in the course of their leveraged buyout, had "hastened Jevic's bankruptcy by saddling it with debts that it couldn't service." In re Jevic Holding Corp., 787 F.3d 173, 176 (C.A.3 2015). In 2011, the Bankruptcy Court held that the committee had adequately pleaded claims of preferential transfer under § 547 and of fraudulent transfer under § 548. In re Jevic Holding Corp., 2011 WL 4345204 (Bkrtcy.Ct.D.Del., Sept. 15, 2011).

Sun, CIT, Jevic, and the committee then tried to negotiate a settlement of this "fraudulent-conveyance" lawsuit. By that point, the depleted Jevic estate's only remaining assets were the fraudulent-conveyance claim itself and \$1.7 million in cash, which was subject to a lien held by Sun

The parties reached a settlement agreement. It provided (1) that the Bankruptcy Court would dismiss the fraudulent-conveyance action with prejudice; (2) that CIT would deposit \$2 million into an account earmarked to pay the committee's legal fees and administrative expenses; (3) that Sun would assign its lien on Jevic's remaining \$1.7 million to a trust, which would pay taxes and administrative expenses and distribute the remainder on a pro rata basis to the low-priority general unsecured creditors, but which would not distribute anything to petitioners (who, by virtue of their WARN judgment, held an \$8.3 million mid-level-priority wage claim against the estate); and (4) that Jevic's Chapter 11 bankruptcy would be dismissed.

Apparently Sun insisted on a distribution that would skip petitioners because petitioners' WARN suit against Sun was still pending and Sun did not want to help finance that litigation. See 787 F.3d, at 177–178, n. 4 (Sun's counsel acknowledging before the Bankruptcy Court that "Sun probably does care where the money goes because you can take judicial notice that there's a pending WARN action against Sun by the WARN plaintiffs. And if the money goes to the WARN plaintiffs, then you're funding someone who is suing you who otherwise doesn't have funds and is doing it on a contingent fee basis' "). The essential point is that, regardless of the reason, the proposed settlement called for a structured dismissal that provided for distributions that did not follow ordinary priority rules.

Sun, CIT, Jevic, and the committee asked the Bankruptcy Court to approve the settlement and dismiss the case. Petitioners and the U.S. Trustee objected, arguing that the settlement's distribution plan violated the Code's priority scheme because it skipped petitioners—who, by virtue of their WARN judgment, had mid-level priority claims against estate assets—and distributed estate money to low-priority general unsecured creditors.

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The Bankruptcy Court agreed with petitioners that the settlement's distribution scheme failed to follow ordinary priority *982 rules. App. to Pet. for Cert. 58a. But it held that this did not bar approval. Ibid. That, in the Bankruptcy Court's view, was because the proposed payouts would occur pursuant to a structured dismissal of a Chapter 11 petition rather than an approval of a Chapter 11 plan. *Ibid*. The court accordingly decided to grant the motion in light of the "dire circumstances" facing the estate and its creditors. Id., at 57a. Specifically, the court predicted that without the settlement and dismissal, there was "no realistic prospect" of a meaningful distribution for anyone other than the secured creditors. Id., at 58a. A confirmable Chapter 11 plan was unattainable. And there would be no funds to operate, investigate, or litigate were the case converted to a proceeding in Chapter 7. Ibid.

The District Court affirmed the Bankruptcy Court. It recognized that the settlement distribution violated ordinary priority rules. But those rules, it wrote, were "not a bar to the approval of the settlement as [the settlement] is not a reorganization plan." *In re Jevic Holding Corp.*, 2014 WL 268613, *3 (D.Del., Jan. 24, 2014).

The Third Circuit affirmed the District Court by a vote of 2 to 1. 787 F.3d, at 175; *id.*, at 186 (Scirica, J., concurring in part and dissenting in part). The majority held that structured dismissals need not always respect priority. Congress, the court explained, had only "codified the absolute priority rule ... in the specific context of plan confirmation." *Id.*, at 183. As a result, courts could, "in rare instances like this one, approve structured dismissals that do not strictly adhere to the Bankruptcy Code's priority scheme." *Id.*, at 180.

Petitioners (the workers with the WARN judgment) sought certiorari. We granted their petition.

Π

[17] Respondents initially argue that petitioners lack standing because they have suffered no injury, or at least no injury that will be remedied by a decision in their favor. See *Spokeo, Inc. v. Robins,* 578 U.S. —, —, 136 S.Ct. 1540, 1547, 194 L.Ed.2d 635 (2016) (explaining that, for Article III standing, a plaintiff must have "(1) suffered an injury in fact, (2) that is fairly traceable to the challenged conduct of the

defendant, and (3) that is likely to be redressed by a favorable judicial decision"). Respondents concede that the structured dismissal approved by the Bankruptcy Court contained distribution conditions that skipped over petitioners, ensuring that petitioners received nothing on their multimillion-dollar WARN claim against the Jevic estate. But respondents still assert that petitioners suffered no loss.

The reason, respondents say, is that petitioners would have gotten nothing even if the Bankruptcy Court had never approved the structured dismissal in the first place, and will still get nothing if the structured dismissal is undone now. Reversal will eliminate the settlement of the committee's fraudulent-conveyance lawsuit, which was conditioned on the Bankruptcy Court's approval of the priority-violating structured dismissal. If the Bankruptcy Court cannot approve that dismissal, respondents contend, Sun and CIT will no longer agree to settle. Nor will petitioners ever be able to obtain a litigation recovery. Hence there will be no lawsuit money to distribute. And in the absence of lawsuit money, Jevic's assets amount to about \$1.7 million, all pledged to Sun, leaving nothing for anyone else, let alone petitioners. Thus, even if petitioners are right that the structured dismissal was impermissible, it cost them nothing. And a judicial decision in their favor will gain them nothing. No loss. No redress.

*983 This argument, however, rests upon respondents' claims (1) that, without a violation of ordinary priority rules, there will be no settlement, and (2) that, without a settlement, the fraudulent-conveyance lawsuit has no value. In our view, the record does not support either of these propositions.

As to the first, the record indicates that a settlement that respects ordinary priorities remains a reasonable possibility. It makes clear (as counsel made clear before our Court, see Tr. of Oral Arg. 58) that Sun insisted upon a settlement that gave petitioners nothing only because it did not want to help fund petitioners' WARN lawsuit against it. See 787 F.3d, at 177–178, n. 4. But, Sun has now won that lawsuit. See 656 Fed.Appx. 617. If Sun's given reason for opposing distributions to petitioners has disappeared, why would Sun not settle while permitting some of the settlement money to go to petitioners?

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As to the second, the record indicates that the fraudulent-conveyance claim could have litigation value. CIT and Sun, after all, settled the lawsuit for \$3.7 million, which would make little sense if the action truly had no chance of success. The Bankruptcy Court could convert the case to Chapter 7, allowing a Chapter 7 trustee to pursue the suit against Sun and CIT. Or the court could simply dismiss the Chapter 11 bankruptcy, thereby allowing petitioners to assert the fraudulent-conveyance claim themselves. Given these possibilities, there is no reason to believe that the claim could not be pursued with counsel obtained on a contingency basis. Of course, the lawsuit—like any lawsuit—might prove fruitless, but the mere possibility of failure does not eliminate the value of the claim or petitioners' injury in being unable to bring it.

[18] Consequently, the Bankruptcy Court's approval of the structured dismissal cost petitioners something. They lost a chance to obtain a settlement that respected their priority. Or, if not that, they lost the power to bring their own lawsuit on a claim that had a settlement value of \$3.7 million. For standing purposes, a loss of even a small amount of money is ordinarily an "injury." See, e.g., McGowan v. Maryland, 366 U.S. 420, 430-431, 81 S.Ct. 1101, 6 L.Ed.2d 393 (1961) (finding that appellants fined \$5 plus costs had standing to assert an Establishment Clause challenge). And the ruling before us could well have cost petitioners considerably more. See *Clinton v*. City of New York, 524 U.S. 417, 430-431, 118 S.Ct. 2091, 141 L.Ed.2d 393 (1998) (imposition of a "substantial contingent liability" qualifies as an injury). A decision in petitioners' favor is likely to redress that loss. We accordingly conclude that petitioners have standing.

Ш

[19] We turn to the basic question presented: Can a bankruptcy court approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent? Our simple answer to this complicated question is "no."

[20] The Code's priority system constitutes a basic underpinning of business bankruptcy law. Distributions of estate assets at the termination of a business bankruptcy normally take place through a Chapter 7 liquidation or a Chapter 11 plan, and both are governed by priority. In Chapter 7 liquidations, priority is an absolute command

—lower priority creditors cannot receive anything until higher priority creditors have been paid in full. See 11 U.S.C. §§ 725, 726. Chapter 11 plans provide somewhat more flexibility, but a priority-violating plan still cannot be confirmed over the objection of an impaired class of creditors. See § 1129(b).

*984 The priority system applicable to those distributions has long been considered fundamental to the Bankruptcy Code's operation. See H.R.Rep. No. 103–835, p. 33 (1994) (explaining that the Code is "designed to enforce a distribution of the debtor's assets in an orderly manner ... in accordance with established principles rather than on the basis of the inside influence or economic leverage of a particular creditor"); Roe & Tung, Breaking Bankruptcy Priority: How Rent-Seeking Upends The Creditors' Bargain, 99 Va. L. Rev. 1235, 1243, 1236 (2013) (arguing that the first principle of bankruptcy is that "distribution conforms to predetermined statutory and contractual priorities," and that priority is, "quite appropriately, bankruptcy's most important and famous rule"); Markell, Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations, 44 Stan. L. Rev. 69, 123 (1991) (stating that a fixed priority scheme is recognized as "the cornerstone of reorganization practice and theory").

The importance of the priority system leads us to expect more than simple statutory silence if, and when, Congress were to intend a major departure. See *Whitman v. American Trucking Assns., Inc.,* 531 U.S. 457, 468, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001) ("Congress ... does not, one might say, hide elephants in mouseholes"). Put somewhat more directly, we would expect to see some affirmative indication of intent if Congress actually meant to make structured dismissals a backdoor means to achieve the exact kind of nonconsensual priority-violating final distributions that the Code prohibits in Chapter 7 liquidations and Chapter 11 plans.

We can find nothing in the statute that evinces this intent. The Code gives a bankruptcy court the power to "dismiss" a Chapter 11 case. § 1112(b). But the word "dismiss" itself says nothing about the power to make nonconsensual priority-violating distributions of estate value. Neither the word "structured," nor the word "conditions," nor anything else about distributing estate value to creditors pursuant to a dismissal appears in any relevant part of the Code.

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Insofar as the dismissal sections of Chapter 11 foresee any transfer of assets, they seek a restoration of the prepetition financial status quo. See § 349(b)(1) (dismissal ordinarily reinstates a variety of avoided transfers and voided liens); § 349(b)(2) (dismissal ordinarily vacates certain types of bankruptcy orders); § 349(b)(3) (dismissal ordinarily "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case"); see also H.R.Rep. No. 95–595, p. 338 (1977) (dismissal's "basic purpose ... is to undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case").

Section 349(b), we concede, also says that a bankruptcy judge may, "for cause, orde[r] otherwise." But, read in context, this provision appears designed to give courts the flexibility to "make the appropriate orders to protect rights acquired in reliance on the bankruptcy case." H.R.Rep. No. 95-595, at 338; cf., e.g., Wiese v. Community Bank of Central Wis., 552 F.3d 584, 590 (C.A.7 2009) (upholding, under § 349(b), a Bankruptcy Court's decision not to reinstate a debtor's claim against a bank that gave up a lien in reliance on the claim being released in the debtor's reorganization plan). Nothing else in the Code authorizes a court ordering a dismissal to make general end-of-case distributions of estate assets to creditors of the kind that normally take place in a Chapter 7 liquidation or Chapter 11 plan—let alone final distributions that do *985 not help to restore the status quo ante or protect reliance interests acquired in the bankruptcy, and that would be flatly impermissible in a Chapter 7 liquidation or a Chapter 11 plan because they violate priority without the impaired creditors' consent. That being so, the word "cause" is too weak a reed upon which to rest so weighty a power. See United Sav. Assn. of Tex. v. Timbers of Inwood Forest Associates, Ltd., 484 U.S. 365, 371, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988) (noting that "[s]tatutory construction ... is a holistic endeavor" and that a court should select a "meanin[g that] produces a substantive effect that is compatible with the rest of the law"); Kelly v. Robinson, 479 U.S. 36, 43, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986) (in interpreting a statute, a court "must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy" (internal quotation marks omitted)); cf. *In re Sadler*, 935 F.2d 918, 921 (C.A.7 1991) (" 'Cause' under § 349(b) means an acceptable reason.

Desire to make an end run around a statute is not an adequate reason").

We have found no contrary precedent, either from this Court, or, for that matter, from lower court decisions reflecting common bankruptcy practice. The Third Circuit referred briefly to *In re Buffet Partners, L.P.,* 2014 WL 3735804 (Bkrtcy.Ct.N.D.Tex., July 28, 2014). The court in that case approved a structured dismissal. (We express no view about the legality of structured dismissals in general.) But at the same time it pointed out "that not one party with an economic stake in the case has objected to the dismissal in this manner." *Id.*, at *4.

The Third Circuit also relied upon *In re Iridium Operating LLC*, 478 F.3d 452 (C.A.2 2007). But *Iridium* did not involve a structured dismissal. It addressed an *interim* distribution of settlement proceeds to fund a litigation trust that would press claims on the estate's behalf. See *id.*, at 459–460. The *Iridium* court observed that, when evaluating this type of preplan settlement, "[i]t is difficult to employ the rule of priorities" because "the nature and extent of the Estate and the claims against it are *not yet fully resolved*." *Id.*, at 464 (emphasis added). The decision does not state or suggest that the Code authorizes nonconsensual departures from ordinary priority rules in the context of a dismissal—which is a *final* distribution of estate value—and in the absence of any further unresolved bankruptcy issues.

We recognize that Iridium is not the only case in which a court has approved interim distributions that violate ordinary priority rules. But in such instances one can generally find significant Code-related objectives that the priority-violating distributions serve. Courts, for example, have approved "first-day" wage orders that allow payment of employees' prepetition wages, "critical vendor" orders that allow payment of essential suppliers' prepetition invoices, and "roll-ups" that allow lenders who continue financing the debtor to be paid first on their prepetition claims. See Cybergenics, 330 F.3d, at 574, n. 8; D. Baird, Elements of Bankruptcy 232–234 (6th ed. 2014); Roe, 99 Va. L. Rev., at 1250-1264. In doing so, these courts have usually found that the distributions at issue would "enable a successful reorganization and make even the disfavored creditors better off." In re Kmart Corp., 359 F.3d 866, 872 (C.A.7 2004) (discussing the justifications for critical-vendor orders); see also *Toibb v. Radloff*, 501 U.S. 157, 163-164, 111 S.Ct. 2197, 115 L.Ed.2d 145 (1991)

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(recognizing "permitting business debtors to reorganize and restructure their debts in order to revive the debtors' businesses" and "maximizing the value of the bankruptcy estate" as purposes of the Code). By way of contrast, in a structured *986 dismissal like the one ordered below, the priority-violating distribution is attached to a final disposition; it does not preserve the debtor as a going concern; it does not make the disfavored creditors better off; it does not promote the possibility of a confirmable plan; it does not help to restore the *status quo ante*; and it does not protect reliance interests. In short, we cannot find in the violation of ordinary priority rules that occurred here any significant offsetting bankruptcy-related justification.

Rather, the distributions at issue here more closely resemble proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards. See, e.g., In re Braniff Airways, Inc., 700 F.2d 935, 940 (C.A.5 1983) (prohibiting an attempt to "short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan sub rosa in connection with a sale of assets"); In re Lionel Corp., 722 F.2d 1063, 1069 (C.A.2 1983) (reversing a Bankruptcy Court's approval of an asset sale after holding that § 363 does not "gran[t] the bankruptcy judge carte blanche" or "swallo[w] up Chapter 11's safeguards"); In re Biolitec, Inc., 528 B.R. 261, 269 (Bkrtcy.Ct.N.J.2014) (rejecting a structured dismissal because it "seeks to alter parties' rights without their consent and lacks many of the Code's most important safeguards"); cf. In re Chrysler LLC, 576 F.3d 108, 118 (C.A.2 2009) (approving a § 363 asset sale because the bankruptcy court demonstrated "proper solicitude for the priority between creditors and deemed it essential that the [s]ale in no way upset that priority"), vacated as moot, 592 F.3d 370 (C.A.2 2010) (per curiam).

IV

We recognize that the Third Circuit did not approve nonconsensual priority-violating structured dismissals in general. To the contrary, the court held that they were permissible only in those "rare case[s]" in which courts could find "sufficient reasons" to disregard priority. 787 F.3d, at 175, 186. Despite the "rare case" limitation, we still cannot agree.

For one thing, it is difficult to give precise content to the concept "sufficient reasons." That fact threatens to turn a "rare case" exception into a more general rule. Consider the present case. The Bankruptcy Court feared that (1) without the worker-skipping distribution, there would be no settlement, (2) without a settlement, all the unsecured creditors would receive nothing, and consequently (3) its distributions would make some creditors (high- and low-priority creditors) better off without making other (mid-priority) creditors worse off (for they would receive nothing regardless). But, as we have pointed out, the record provides equivocal support for the first two propositions. See *supra*, at 982 – 983. And, one can readily imagine other cases that turn on comparably dubious predictions. The result is uncertainty. And uncertainty will lead to similar claims being made in many, not just a few, cases. See Rudzik, A Priority Is a Priority Is a Priority— Except When It Isn't, 34 Am. Bankr. Inst. J. 16, 79 (2015) ("[O]nce the floodgates are opened, debtors and favored creditors can be expected to make every case that 'rare case' ").

The consequences are potentially serious. They include departure from the protections Congress granted particular classes of creditors. See, e.g., United States v. Embassy Restaurant, Inc., 359 U.S. 29, 32, 79 S.Ct. 554, 3 L.Ed.2d 601 (1959) (Congress established employee wage priority "to alleviate in some degree the hardship that unemployment usually brings to workers and their families" when an employer files for bankruptcy); *987 H.R.Rep. No. 95-595, at 187 (explaining the importance of ensuring that employees do not "abandon a failing business for fear of not being paid"). They include changes in the bargaining power of different classes of creditors even in bankruptcies that do not end in structured dismissals. See Warren, A Theory of Absolute Priority, 1991 Ann. Survey Am. L. 9, 30. They include risks of collusion, i.e., senior secured creditors and general unsecured creditors teaming up to squeeze out priority unsecured creditors. See Bank of America Nat. Trust and Sav. Assn. v. 203 North LaSalle Street Partnership, 526 U.S. 434, 444, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999) (discussing how the absolute priority rule was developed in response to "concern with 'the ability of a few insiders, whether representatives of management or major creditors, to use the reorganization process to gain an unfair advantage' " (quoting H.R. Doc. No. 93-137, pt. I, p. 255 (1973))). And they include making settlement more difficult to achieve. See Landes & Posner, Legal

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Precedent: A Theoretical and Empirical Analysis, 19 J. Law & Econ. 249, 271 (1976) (arguing that "the ratio of lawsuits to settlements is mainly a function of the amount of uncertainty, which leads to divergent estimates by the parties of the probable outcome"); see also *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 649, 132 S.Ct. 2065, 182 L.Ed.2d 967 (2012) (noting the importance of clarity and predictability in light of the fact that the "Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law").

[21] For these reasons, as well as those set forth in Part III, we conclude that Congress did not authorize a "rare case" exception. We cannot "alter the balance struck by the statute," Law v. Siegel, 571 U.S. ——, ——, 134 S.Ct. 1188, 1198, 188 L.Ed.2d 146 (2014), not even in "rare cases." Cf. Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 207, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988) (explaining that courts cannot deviate from the procedures "specified by the Code," even when they sincerely "believ[e] that ... creditors would be better off"). The judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

Justice THOMAS, with whom Justice ALITO joins, dissenting.

Today, the Court answers a novel and important question of bankruptcy law. Unfortunately, it does so without the benefit of any reasoned opinions on the dispositive issue from the courts of appeals (apart from the Court of Appeals' opinion in this case) and with briefing on that issue from only one of the parties. That is because, having persuaded us to grant certiorari on one question, petitioners chose to argue a different question on the merits. In light of that switch, I would dismiss the writ of certiorari as improvidently granted.

We granted certiorari to decide "[w]hether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme." Pet. for Cert. i. According to petitioners, the decision below "deepened an existing ... split" among the Courts of Appeals on this question. *Id.*, at 8; see

id., at 15–16 (citing *In re AWECO, Inc.,* 725 F.2d 293, 298 (C.A.5 1984), and *In re Iridium Operating LLC,* 478 F.3d 452, 464 (C.A.2 2007)). After we granted certiorari, however, petitioners recast the question presented to ask "[w]hether a Chapter 11 case may be terminated by a 'structured dismissal' that distributes estate property in violation of the Bankruptcy Code's priority scheme." Brief for Petitioners i. Although both questions *988 involve priority-skipping distributions of estate assets, the recast question is narrower—and different—than the one on which we granted certiorari. It is also not the subject of a circuit conflict.

I think it is unwise for the Court to decide the reformulated question today, for two reasons. First, it is a "novel question of bankruptcy law" arising in the rapidly developing field of structured dismissals. In re Jevic Holding Corp., 787 F.3d 173, 175 (C.A.3 2015). Experience shows that we would greatly benefit from the views of additional courts of appeals on this question. We also would have benefited from full, adversarial briefing. In reliance on this Court's Rules prohibiting parties from changing the substance of the question presented, see Rule 24.1(a); see also Rule 14.1(a), respondents declined to brief the question that the majority now decides, see Brief for Respondents 52. Second, deciding this question may invite future petitioners to seek review of a circuit conflict only then to change the question to one that seems more favorable. "I would not reward such bait-and-switch tactics." City and County of San Francisco v. Sheehan, 575 U.S. —, —, 135 S.Ct. 1765, 1779, 191 L.Ed.2d 856 (2015) (Scalia, J., concurring in part and dissenting in part); see also Visa, Inc. v. Osborn, — U.S. —, —, 136 S.Ct. 2543, 195 L.Ed.2d 867 (2016) *post*, *p*. ——.

Accordingly, I would dismiss the writ as improvidently granted. I respectfully dissent.

All Citations

137 S.Ct. 973, 197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242, Bankr. L. Rep. P 83,082, 41 IER Cases 1613, 17 Cal. Daily Op. Serv. 2766, 2017 Daily Journal D.A.R. 2805, 26 Fla. L. Weekly Fed. S 495

Footnotes

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* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

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In re Fundamental Long Term Care, Inc., 489 B.R. 451 (2013)

489 B.R. 451
United States Bankruptcy Court,
M.D. Florida,
Tampa Division.

In re FUNDAMENTAL LONG TERM CARE, INC., Debtor.

No. 8:11-bk-22258-MGW. | March 19, 2013.

Synopsis

Background: Following a ruling that Chapter 7 trustee had the right to control the defense of debtor's wholly-owned subsidiary, a defunct and administratively dissolved nondebtor entity, in a series of wrongful death cases that had been brought against subsidiary and its former parent company, which had been represented by the same lawyers, trustee retained new counsel to defend subsidiary and subsequently filed Rule 2004 motions seeking the litigation files from subsidiary's former lawyers so its new counsel could prepare its defense and investigate potential claims against former parent's receiver and against subsidiary's former counsel. Law firms that had represented subsidiary and its former parent objected, citing former parent's attorney-client privilege, the common interest doctrine, and the work product doctrine.

Holdings: The Bankruptcy Court, Michael G. Williamson, J., held that:

- [1] under Florida law, subsidiary was a client of the law firms after it was sold to debtor;
- [2] addressing a novel issue, trustee, standing in subsidiary's shoes, was entitled to invoke the co-client exception to the attorney-client privilege to obtain communications relating to the defense of the wrongful death cases;
- [3] the co-client exception only applied to communications about the defense of the wrongful death cases;
- [4] communications among parties to settlement agreement, as well as their lawyers, relating to the defense

of the wrongful death claims were not protected from disclosure to trustee by the common interest doctrine; and

[5] under either federal or state law, subsidiary's former counsel could not use the work product doctrine to deny trustee access to the litigation files.

So ordered.

See also 2012 WL 4815321.

West Headnotes (21)

[1] Attorney and Client

What constitutes a retainer

Corporations and Business Organizations

Construction, operation, and effect in general

Under Florida law, wholly-owned subsidiary of Chapter 7 debtor had attorney-client relationship with law firms retained by its former parent company and/or former parent's state court-appointed receiver to represent it and former parent in series of wrongful death cases, even after subsidiary was sold to debtor and went out of business; whether former parent or its receiver technically retained the firms or paid their fees was not determinative, former parent and its receiver were contractually obligated under indemnification provision of stock purchase agreement to retain counsel on behalf of subsidiary and direct its defense in the wrongful death cases, and the firms provided legal services to subsidiary, holding themselves out as representing subsidiary, appearing or attempting to appear on subsidiary's behalf in the wrongful death cases, and in some instances actually taking action on subsidiary's behalf in those cases.

Cases that cite this headnote

[2] Attorney and Client

What constitutes a retainer

Insurance

In re Fundamental Long Term Care, Inc., 489 B.R. 451 (2013)

Conflicts of interest;independent counsel

Under Florida law, the insured is the client, even where an insurer retains and pays for counsel to represent the insured.

1 Cases that cite this headnote

[3] Privileged Communications and Confidentiality

Common interest doctrine; joint clients or joint defense

Under Florida law, the "co-client exception to the attorney-client privilege" holds that where a lawyer represents two clients in the same case, communications between the lawyer and one client are not confidential as to the other client.

2 Cases that cite this headnote

[4] Privileged Communications and Confidentiality

Common interest doctrine; joint clients or joint defense

Under Florida law, the co-client exception to the attorney-client privilege applies regardless of whether both parties are present when the communication is made.

6 Cases that cite this headnote

[5] Bankruptcy

Privilege

Under Florida law, Chapter 7 trustee, standing in shoes of debtor's wholly-owned non-debtor subsidiary, was entitled to invoke co-client exception to attorney-client privilege to obtain communications between subsidiary's former parent company and counsel for former parent and subsidiary relating to defense of wrongful death cases that had been brought against subsidiary and former parent; although subsidiary was defunct and had had no communication with any of the lawyers, former parent and/or its state court-appointed receiver owed subsidiary a fiduciary duty with

respect to defending the wrongful death cases pursuant to indemnification provision of stock purchase agreement, the parties contractually agreed to equal access to information, and the parties had identical interests in defending the wrongful death cases, such that it was not reasonable for receiver to claim he had a reasonable expectation of privacy sufficient to preclude application of the co-client exception.

2 Cases that cite this headnote

[6] Insurance

► In general; nature and source of duty

Under Florida law, an insurer's duty to defend rises to the level of a fiduciary duty.

Cases that cite this headnote

[7] Insurance

Fulfillment of Duty and Conduct of Defense

Under Florida law, an insurer's duty to defend obligates the insurer to use the same degree of care and diligence in defending an insured as an insurer of ordinary care and prudence should exercise in the management of its own business.

Cases that cite this headnote

[8] Privileged Communications and Confidentiality

Common interest doctrine; joint clients or joint defense

Purpose of the co-client exception to the attorney-client privilege is to: (1) prevent unjustifiable inequality in access to information necessary to fairly resolve disputes that arise between parties who were in the past joint clients, and (2) discourage abuses of fiduciary obligations and encourage parties to honor any legal duties they had to share information related to common interests.

Cases that cite this headnote

In re Fundamental Long Term Care, Inc., 489 B.R. 451 (2013)

[9] Bankruptcy

Privilege

Where, under Florida law, Chapter 7 trustee, standing in shoes of debtor's wholly-owned non-debtor subsidiary, was entitled to invoke the co-client exception to the attorney-client privilege to obtain communications between subsidiary's former parent company and counsel for former parent and subsidiary relating to defense of wrongful death cases that had been brought against subsidiary and former parent, the co-client exception was limited to communications about the defense of the wrongful death cases, and did not apply regarding matters unrelated to those cases; subsidiary did not have any contractual right to access information related to those other matters, nor did subsidiary's former parent or its state court-appointed receiver owe subsidiary a fiduciary duty with respect to anything other than the defense of the wrongful death cases.

4 Cases that cite this headnote

[10] Privileged Communications and Confidentiality

Agents or employees of attorney or client in general

Under Florida law, the attorney-client privilege extends not only to the lawyer giving advice, but to any persons assisting the lawyer in providing legal services.

Cases that cite this headnote

[11] Privileged Communications and Confidentiality

Corporations, partnerships, associations, and other entities

Privileged Communications and Confidentiality

Agents or employees of attorney or client in general

Under Florida law, the attorney-client privilege extends to the client's in-house counsel and agents.

Cases that cite this headnote

[12] Bankruptcy

Privilege

law, Under Florida communications between entity that provided "back office administrative services," including in-house counsel services, to nursing facility operators nationwide, including to the former parent of Chapter 7 debtor's wholly-owned non-debtor subsidiary, and lawyers that represented former parent and subsidiary in wrongful death cases, though protected from disclosure to third parties pursuant to the attorney-client privilege, were available to subsidiary, and to Chapter 7 trustee standing in subsidiary's shoes, under the co-client exception to the attorney-client privilege; entity was facilitating subsidiary's defense, as well as the defense of former parent.

Cases that cite this headnote

[13] Privileged Communications and Confidentiality

Corporations, partnerships, associations, and other entities

Under federal law, the attorney-client privilege attaches where the client is a corporation, and where the attorney is inhouse counsel.

Cases that cite this headnote

[14] Bankruptcy

Privilege

Communications strictly between the former parent of Chapter 7 debtor's wholly-owned non-debtor subsidiary, or the state court-appointed receiver for parent, and entity that provided "back office administrative services," including in-house counsel services, to nursing facility operators nationwide, including the former parent, were not subject to the co-client exception to the attorney-client privilege where entity effectively served as former parent's in-house counsel.

In re Fundamental Long Term Care, Inc., 489 B.R. 451 (2013)

Cases that cite this headnote

[15] Privileged Communications and Confidentiality

Common interest doctrine; joint clients or joint defense

Under Florida law, the "common interest doctrine" protects the free flow of information from attorney to client by providing that clients and their respective attorneys sharing common litigation interests may exchange information freely among themselves without fear that by their exchange they will forfeit the protection of the attorney-client privilege.

Cases that cite this headnote

[16] Bankruptcy

Privilege

Under Florida law, communications among parties to settlement agreement, as well as their lawyers, relating to the defense of wrongful death claims that had been brought against debtor's wholly-owned nondebtor subsidiary and its former parent company, though protected by the common interest doctrine from disclosure to third parties, were not protected from disclosure to Chapter 7 trustee, standing in shoes of subsidiary; the interests of all parties to the settlement agreement were identical with respect to the defense of the wrongful death cases, and though state court-appointed receiver for former parent argued that the communications at issue were, for the most part, subsumed under a joint defense agreement, enforcing the joint defense agreement to deny trustee access to the communications would have been contrary to the goals of bankruptcy and hence against public policy.

Cases that cite this headnote

[17] Privileged Communications and Confidentiality

Common interest doctrine; joint clients or joint defense

While the general rule is that parties that share information under the common interest doctrine cannot invoke the attorney-client privilege in subsequent adverse litigation between them, if there are multiple members that share information, and only two become adverse, the party seeking communications is entitled to all communications between members with common interests, not just communications with the adverse party.

Cases that cite this headnote

[18] Bankruptcy

Privilege

Under either federal or Florida law, former counsel of Chapter 7 debtor's wholly-owned non-debtor subsidiary, which had represented subsidiary and its former parent company in wrongful death litigation that had been brought against them, could not use the work product doctrine to deny trustee, standing in shoes of subsidiary, the former client, access to litigation files from the wrongful death cases.

2 Cases that cite this headnote

[19] Bankruptcy

Privilege

Purpose of shielding attorney work product from disclosure is to protect the adversarial process by providing an environment of privacy in which a litigator may creatively develop strategies, legal theories, and mental impressions outside the ordinary realm of federal discovery provisions, thereby insuring that the litigator's opponent is unable to ride on the litigator's wits.

Cases that cite this headnote

[20] Privileged Communications and Confidentiality

Common interest doctrine; joint clients or joint defense

In re Fundamental Long Term Care, Inc., 489 B.R. 451 (2013)

Privileged Communications and Confidentiality

Waiver of privilege

Where a party receives communications under the co-client exception to the attorney-client privilege and the common interest doctrine, the party is prohibited from disclosing the communications to third parties; waiver of the privilege under those circumstances requires consent of all of the parties who share the privilege.

4 Cases that cite this headnote

[21] Privileged Communications and Confidentiality

Absolute or qualified privilege

Although the attorney-client privilege fosters an important public interest of full and frank disclosure between attorneys and their clients, it is not absolute.

Cases that cite this headnote

Attorneys and Law Firms

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MEMORANDUM OPINION ON ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT ISSUES

MICHAEL G. WILLIAMSON, Bankruptcy Judge.

Where a lawyer represents two clients in the same case, communications between the lawyer and one client ordinarily are not confidential as to the other client. Here, Trans Health Management, Inc. *455 ("THMI") and Trans Health, Inc. ("THI") have been represented by the same lawyers in a series of wrongful death cases. THMI is the wholly owned subsidiary of the Debtor in this case, and THI is THMI's former parent. THI (and later its court-appointed receiver) retained counsel to defend THMI, which has been defunct since it was sold to the Debtor in 2006, in the wrongful death cases.

The Court recently ruled that the Chapter 7 Trustee has the right to control THMI's defense in those cases (including its rights with respect to the attorney-client privilege and attorney work product). Since that ruling, the Trustee has retained new counsel to defend THMI. And now she wants the litigation files (including all attorney-client communications and work product) from the lawyers representing THI and THMI so her new lawyers can prepare THMI's defense. She also wants the files to investigate potential breach of fiduciary duty and malpractice claims she believes she has against THI's Receiver and THMI's former counsel for letting more than \$1 billion in judgments get entered against THMI in three of the wrongful death cases. But the law firms representing THI and THMI have refused to turn over their litigation files based on the attorney-client privilege, common interest doctrine, and work product doctrine.

This Court concludes that the Trustee (standing in THMI's shoes) is entitled to invoke the co-client exception to the attorney-client privilege to obtain communications relating to the defense of the wrongful death cases. THI (and the Receiver) owed THMI a fiduciary duty in retaining counsel for THMI and directing its defense under an indemnification agreement. ¹ And under that indemnification agreement, THMI had the right to access the litigation files for the wrongful death cases. So the Trustee is entitled to any communications between THI (or the Receiver) and the law firms representing THI and

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THMI—as well as communications between those law firms and Fundamental Administrative Services—relating to the defense of the wrongful death cases.

The Trustee is also entitled to communications among the parties to a January 5, 2012 settlement agreement (as well as their lawyers) relating to the defense of those claims. It is true that THI (and the Receiver) share an interest in avoiding liability for wrongful death (and collection of any wrongful death judgment) with parties to the settlement agreement. But THMI shares the same interest in avoiding liability (although not collection on any liability). So while the common interest exception applies to protect communications between parties to the settlement agreement relating to the defense of the *456 wrongful death cases from disclosure to third parties, it cannot be used to protect those communications from disclosure to THMI. The Court cannot conceive of any basis for THMI's attorneys to refuse to share communications they received from other parties with identical interests in the wrongful death cases.

Nor can THMI's former counsel use the work product doctrine to deny the Trustee access to the litigation files (including attorney work product). THMI, as a former client, is presumptively entitled to its files. And courts uniformly agree that an attorney cannot invoke the work product doctrine to deny its client access to its files. There is no policy reason to deviate from that well-accepted rule.

There are, however, two significant limitations on the Court's ruling. First, the Trustee is only entitled to communications or litigation files relating to the defense of the wrongful death cases. The Trustee is not entitled to any communications regarding this bankruptcy case or any matters unrelated to the defense of the wrongful death cases. Second, the Trustee and her attorneys cannot disclose to any third parties (specifically the plaintiffs in the wrongful death cases) any communications they receive under the co-client exception—other than agents assisting the Trustee and THMI's new counsel.

Background

The Parties

Before March 2006, THI owned a number of subsidiaries that operated nursing homes throughout the United

States. THMI, which was a THI subsidiary at the time, provided "back office" administrative support for the nursing homes operated by the other THI subsidiaries. In March 2006, THI sold its stock in THMI to the Debtor under a stock purchase agreement. After it was sold to the Debtor, THMI stopped providing support to the other THI subsidiaries and eventually was administratively dissolved. THMI is currently a defunct entity. In 2009, THI (and its remaining subsidiaries) filed for receivership in Maryland, and the Maryland state court appointed a receiver to manage THI's assets. 3

The Wrongful Death Cases

Two years before the stock purchase agreement, the first of six wrongful death claims—*Estate of Jackson*—was filed. ⁴ Two more cases—*Estate of Nunziata* and *Estate of Jones*—were filed before the stock purchase agreement. ⁵ Another two cases—*Estate of Webb* and *Estate of Sasser*—were filed just months after the stock purchase agreement. ⁶ And the last case—*Estate of Townsend*—was filed in 2009. ⁷ THI and THMI were co-defendants in all but the *Nunziata* case (just THMI was a defendant in that case).

Retention of Counsel

Before filing for receivership, THI retained the following firms to represent it and THMI in the wrongful death cases: Mancuso & Dias, P.A.; Quintairos Prieto Wood & Boyer, P.A.; Fudge & McArthur, P.A.; and Schutt Schmidt Noey. From the record, it appears that Mancuso & Dias initially represented THI and THMI in the *457 Jackson, Nunziata, and Sasser wrongful death cases. That firm later withdrew, and Quintairos Prieto substituted in as counsel in those cases in 2007. Fudge & McArthur represented THI and THMI in the Jones case, and Schutt Schmidt represented both parties in the Webb case. ⁸ Once THI filed for receivership in 2009, the Receiver took over the defense of THI and THMI in the wrongful death cases.

Defense of the Wrongful Death Cases

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What happened next is—like most of this case—subject to much disagreement. The Receiver says that the Maryland state court set two claims bar dates and that none of the wrongful death plaintiffs filed a claim in THI's receivership proceeding. The Receiver also says that counsel for the wrongful death plaintiffs (Wilkes & McHugh) represented to him on three separate occasions that none of his clients would be filing a claim in the receivership proceeding. Based on that, the Receiver says he stopped his defense of the six wrongful death claims —on behalf of both THI and THMI—around April 2010. Not surprisingly, the wrongful death plaintiffs tell a completely different version of the story. The Court need not resolve that dispute now. What is clear is that in April or May 2010, Quintairos Prieto withdrew as counsel in the Jackson, Nunziata, and Sasser cases. 9

About three months later, the first of three judgments was entered in the wrongful death cases: on July 22, 2010, a \$110 million judgment was entered against THI and THMI in the *Jackson* case after an "empty chair" trial. The plaintiff in *Jackson* then initiated proceedings supplementary against a number of entities (including the Debtor) in an attempt to collect on the judgment. ¹⁰ And on September 13, 2011, a \$110 million judgment was entered against the Debtor and others in the proceedings supplementary. Then, in November 2011, the *Jackson* plaintiff and the plaintiffs in the remaining wrongful death cases sought an order from a state court in Miami–Dade County declaring that they had timely filed claims in the Maryland receivership proceedings. ¹¹

All of this led the Receiver to enter into an agreement with the other parties to the *Jackson* proceedings supplementary regarding the defense of the wrongful death cases. Under that agreement, entered into on January 5, 2012, Fundamental Administrative Services agreed to defend the Receiver against any claims arising out of the wrongful death cases. Fundamental Administrative Services also agreed to defend *458 and oppose the wrongful death cases outside of the receivership proceeding. To fund that defense, Fundamental Administrative Services agreed to deposit \$800,000 into escrow. General Electric Capital Corporation also agreed to deposit another \$200,000. That settlement agreement was later approved by the Maryland receivership court.

Immediately after entering into the settlement agreement, the Receiver retained the Rydberg Law Firm to represent THMI in the *Nunziata* case. A default as to liability had already been entered in that case, and the jury trial on damages was set for January 9, 2012. So the Rydberg firm filed a notice of appearance in that case and moved to vacate the default. But the *Nunziata* plaintiff objected. The *Nunziata* court struck the Rydberg firm's notice of appearance, and the case ultimately proceeded to a jury trial on damages, where the jury—after an "empty chair" trial—entered a \$200 million judgment against THMI on January 11, 2012.

One month later, the last—and by far the largest—of the three judgments was entered in the wrongful death cases. On February 10, 2012, a \$900 million final judgment was entered against THI and THMI in the Webb case. Since the Webb judgment was entered, the Receiver has retained the Rydberg firm and Fowler White Boggs Banker to appeal the Nunziata judgment on behalf of THMI and the Webb judgment on behalf of THI and THMI. Although the underlying final judgment in Jackson has not been appealed, the one-year deadline for vacating it has been stayed pending this case. As of the date of this Memorandum Opinion, then, final judgments totaling just over \$1 billion have been entered against THI and THMI in three of the wrongful death cases (two of which are on appeal), and three cases remain pending.

The Bankruptcy Case

Just three months after obtaining a \$110 million judgment against the Debtor in the *Jackson* proceedings supplementary, the *Jackson* plaintiff initiated this involuntary case under chapter 7. The Debtor did not respond to the involuntary petition, so the Court entered an order for relief requiring the Debtor to file a list of creditors, schedules of assets and liabilities, and a statement of financial affairs within 14 days. ¹² When the Debtor failed to comply with the order for relief, the Court entered a series of show-cause orders that—when taken together—required all law firms or other persons in possession of any books and records belonging to the Debtor or THMI (including any litigation files) to turn them over to the Trustee. ¹³

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The Trustee served the show-cause orders on 15 law firms or individual lawyers. ¹⁴ Five of the lawyers or law firms did not respond; another five lawyers or law firms claimed not to have any responsive documents; and the remaining parties produced a limited number of documents. ¹⁵ So the Trustee asked the Court to (i) direct the 15 lawyers or law firms to show cause why they should not be held in contempt for refusing to turn over all of the books and records (including litigation files) belonging to the Debtor or THMI; and (ii) direct the Rydberg firm and Fowler White (as well as other law firms and *459 attorneys that had been representing THMI in the wrongful death cases) to take no further action on THMI's behalf. ¹⁶

The Receiver objected that the Trustee was not entitled to THMI's litigation files because those documents were protected by the attorney-client privilege. ¹⁷ The Receiver also argued that he—and not the Trustee—was entitled to control THMI's defense in the wrongful death cases. Thus, the Court was faced with a novel issue in resolving the Trustee's show-cause motions: who was entitled to control the defense of a defunct and administratively dissolved non-debtor entity (THMI) in the wrongful death cases. ¹⁸

On the one hand, while the Trustee owned 100% of the stock in THMI, she was not an officer or director of the company, and more importantly, THMI was not in bankruptcy—only its parent company was. According to the Receiver, the mere fact that THMI was a wholly owned subsidiary of the Debtor was not sufficient to allow the Trustee to control THMI. On the other hand, the Receiver had no ownership interest in THMI; it only had the apparent obligation to control THMI's defense under an indemnification agreement.

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In choosing between the Trustee and the Receiver, the Court looked to *Wofford v. Wofford* for guidance. ²⁰ In *Wofford*, the Florida Supreme Court—in the context of considering whether a court of equity could look beyond the legal fiction of a corporate entity and order the sale of the corporation "to do justice between litigants"—cautioned that courts should "not forget that the stockholders are the real and substantial beneficiaries" when looking beyond the corporate form. ²¹ Because the

Trustee was THMI's sole shareholder, the Court decided she should be the one—as between her and the Receiver—to control THMI's defense (including the right to assert any privilege). ²²

Accordingly, the Court authorized the Trustee to file Rule 2004 motions requesting copies of any books and records (including litigation files) relating to the Debtor or THMI. Under the Court's ruling, any person responding to a Rule 2004 motion was given 14 days to comply with the order or file an objection to the requested production on any ground, other than the assertion of THMI's attorney-client privilege. The Trustee filed her *460 Rule 2004 motions seeking documents from the various law firms that represented THI and THMI in the wrongful death cases, and the Receiver and the law firms have objected based on THI's—not THMI's—attorney-client privilege. ²³

Issues Now Before Court ²⁴

The Trustee says THI cannot assert the attorney-client privilege against THMI because THI and THMI are co-clients, and under the co-client exception to the attorney-client privilege, communications between one client and its lawyer are not confidential as to another co-client. The Receiver acknowledges that THI and THMI were co-clients—and, therefore, THMI is entitled to any communications between THI and the lawyers defending the wrongful death cases—up until THMI was sold to the Debtor in March 2006. After it was sold, however, THMI went out of business, and at that point, the Receiver says THMI was no longer a client of the law firms that had been defending the wrongful death cases.

And the Receiver says that any law firms retained after THMI was sold only had an attorney-client relationship with THI or the Receiver (depending on when the firm was retained) because no one from THMI was around to consent to those firms' representation. Plus, the Receiver says that THMI became adverse to THI once the Trustee was appointed in this bankruptcy case. So, at a minimum, any communications between THI (or the Receiver) and its counsel are not subject to the co-client exception after that point. And any communications among the firms and the parties impleaded in the *Jackson* proceedings supplementary are protected from disclosure under the

common interest doctrine and a joint defense agreement. Finally, the Receiver says the law firms' litigation files are protected by the work product doctrine, which THMI cannot waive over the law firms' objections.

Conclusions of Law 25

The threshold issue to be addressed is whether THMI had an attorney-client relationship with any of the law firms that represented it after it was sold to the Debtor. It is unclear whether the Receiver believes THMI was a client of any of those firms. On the one hand, the Receiver argues in his attorney-client privilege brief that THMI had no attorney-client relationship with any of the law firms after it was sold to the Debtor. ²⁶ That view was also echoed by the Rydberg firm in its filings. ²⁷ On the other hand, the Receiver appeared to concede at a February 12, 2012 hearing that THMI "technically" was the client of the firms that represented it in the wrongful death cases. ²⁸ In the end, the Receiver really has no choice but to concede THMI was a client of those firms.

THMI is a client

[1] The argument that THMI was not a client hinges on three facts: (i) at least *461 some of the engagement letters say that the Receiver "retained" the firm to represent THMI; (ii) either THI or the Receiver—and not THMI—paid for the legal services; and (iii) there was no one around from THMI after 2006 to consent to the law firms' representation. But none of those facts—whether considered alone or together—demonstrate that THMI was not a client.

To begin with, whether THI or the Receiver technically retained the law firms or paid their fees is not determinative. The key issue is whether the law firms provided legal services to THMI. In *The Florida Bar v. King*, the Florida Supreme Court considered whether an attorney had entered into an attorney-client relationship with Charles Baldwin in connection with a lawsuit involving Baldwin and his company. ²⁹ There, the attorney wrote a letter to opposing counsel saying that he had been retained by Baldwin; talked to opposing counsel on the phone to secure an extension of time to file an answer on "behalf of [his] client"; and filed an

answer and counterclaim identifying himself as Baldwin's attorney. According to the Florida Supreme Court, filing pleadings in a pending lawsuit on Baldwin's behalf and advising opposing counsel that he represented Baldwin was sufficient to establish an attorney-client relationship in *King.* ³⁰

And the facts in *King* are analogous to those in this case. There really is no dispute that various law firms held themselves out to Wilkes & McHugh as representing THMI. Nor is there any dispute that the law firms appeared—or attempted to appear—on THMI's behalf in the wrongful death cases. ³¹ More importantly, the law firms that did appear as THMI's counsel in the wrongful death cases actually took action on THMI's behalf in those cases. ³² So there is no question that the law firms—like the lawyer in *King*—filed pleadings and held themselves out as THMI's counsel in the wrongful death cases.

The only real argument left is that THMI somehow did not consent to the legal services provided by the law firms. That is why the Receiver principally—although not exclusively—relies on Zych v. Jones for his claim that no attorney-client relationship was created between THMI and the law firms. 33 In Zych, which was a malpractice action, Stanley Zych alleged that J. Edward Jones (an attorney) initially filed an appearance on his behalf in an earlier automobile accident case at the request of George F. Mueller & Sons, Inc.—Zych's employer. 34 Zych apparently told the attorney that he would let him know if he wanted the attorney to represent him. Because Zych never did so, the attorney did not appear on his behalf at trial, and a default judgment was ultimately entered against him. The issue in **Zych** was whether an attorney-client relationship existed between Zych and the attorney.

The Illinois appellate court held no attorney-client relationship existed. At the outset, the court noted that "where an attorney appears of record for a party, it is presumed that the appearance is authorized." ³⁵ But the court went on to note that the presumption is not conclusive and *462 that it may be rebutted by evidence to the contrary. The evidence to the contrary in that case was that (i) there was no retainer agreement between Zych and the attorney in the first place; and (ii) Zych never arranged for the attorney's services later. ³⁶ The

fact that Mueller & Sons (Zych's employer) asked the attorney to represent Zych was not sufficient to create an attorney-client relationship because Mueller & Sons was not acting as Zych's agent. The lack of an agency relationship between Zych and Mueller & Sons was critical to the court's analysis. 37

And that is what distinguishes this case from *Zych*. To be sure, this case is similar to Zych in that a third party (THI or the Receiver depending on the timing) requested that various law firms represent THMI in the wrongful death cases, and like in *Zych*, no THMI officer, director, or employee agreed to those services at the time. ³⁸ But there is one critical difference. Here, THI and the Receiver—unlike the employer in *Zych*—were obligated to retain counsel on behalf of THMI and direct its defense in the wrongful death cases. ³⁹

The Receiver has conceded at various stages of this case that THI was contractually obligated to retain counsel to defend THMI in the wrongful death cases and that he was directing THMI's defense. 40 That contractual duty to defend presumably arose out of the stock purchase agreement, which contains an indemnification provision obligating THMI to retain counsel and defend THMI against any claim relating to any facility operated by a THI subsidiary. Later, when THI went into receivership, the Receiver assumed THI's indemnity obligations. 41 Because THI and the Receiver had the right to retain counsel for THMI and direct its defense, this case is different than *Zych*.

[2] The situation in this case is—as the Receiver suggests—more analogous to cases where an insurer had an obligation to retain counsel to defend its insured. ⁴² The problem with that analogy—at least from the Receiver's perspective—is that it is well settled that the insured is the client even where an insurer retains (and pays for) counsel to represent the insured. ⁴³ In *463 fact, one of the cases cited by the Receiver for the proposition that the attorney-client privilege extends to the client's agents (discussed later in this Opinion) states that "when an insurer accepts the defense obligations of its insured, certain interests of the insured and insurer essentially merge" and that those "common interests bar … the attorney-client privilege from attaching to the communications among the attorney, the insurer, and the insured." ⁴⁴ So

the Receiver really had no choice but to concede at the February 12, 2013 hearing that the insured is the client in that context. ⁴⁵

And so it is in this context, too. The fact that counsel retained by THI and the Receiver actually held themselves out as THMI's counsel, appeared in court on THMI's behalf, and rendered legal services to THMI is sufficient to establish an attorney-client relationship. That, frankly, is the easy part. The hard part is deciding what the consequence of that relationship is. The Trustee contends the existence of the attorney-client relationship, alone, permits her access to otherwise confidential communications between THI and the Receiver and law firms retained to represent them and THMI. According to the Trustee, once it is established that THI and THMI are co-clients, then she is entitled to all communications between THI (and the Receiver) and counsel defending THI and THMI in the wrongful death cases.

That is because the co-client exception to [3] the attorney-client privilege ordinarily holds that where a lawyer represents two clients in the same case, communications between the lawyer and one client are not confidential as to the other client. 46 The co-client exception applies regardless of whether both parties are present when the communication is made. 47 Here, for instance, communications between THI and counsel for THI and THMI ordinarily would not be privileged as to THMI even if THMI was not present-provided the co-client exception applies. But the Receiver says it should not apply here because THI and the Receiver had a reasonable expectation that their communications to lawyers retained to represent THI and THMI would be kept confidential.

The Trustee (standing in THMI's shoes) is entitled to invoke the co-client exception

[5] According to the Receiver, the rationale behind the co-client exception is that co-clients have no expectation that their confidences concerning a joint matter will be kept secret. 48 In this case, the Receiver says he did not have any reason to believe his communications to his lawyers would be disclosed to THMI because THMI was defunct and administratively dissolved. There was literally no one around from THMI at the time the

communications were made. And the Receiver proffers in his filings that he specifically intended that any communications regarding the wrongful death cases (and the implication of those cases in this bankruptcy case) would be kept confidential from not only the wrongful death plaintiffs—but the Trustee as well. Besides, the Receiver says the co-client exception should not apply *464 because THMI did not—nor could it—participate in any of the communications since it was defunct and administratively dissolved.

On this last point, the Trustee cites Ashcraft & Gerel v. Shaw, a Maryland appellate court decision, for the proposition that even a client who did not (or could not) participate in confidential communications is entitled to assert the co-client exception. ⁴⁹ In that case, the courtappointed guardian of a severely retarded child wanted the files of a law firm retained by the child's mother to represent her and her child in two tort actions. The law firm argued that the co-client exception did not apply because the child never participated in any of the communications. The Ashcraft court held that the coclient exception applied regardless of whether both clients were present or participated in the communications. 50 While *Ashcraft* is certainly persuasive, it does not address the Receiver's first point: his claim that he had a reasonable expectation that his communications would be kept private under the unique facts of this case.

The real issue raised by the Receiver—even if not precisely articulated—is whether there are any circumstances where one co-client has a reasonable expectation that any communications made outside the presence of the other client will remain confidential. Not surprisingly, there are no cases involving facts identical to those in this case (i.e., where one of the co-clients has been defunct during most of the representation). There are, however, several decisions discussing whether it is reasonable, taking into account all of the relevant circumstances, for a party to invoke the co-client exception.

Perhaps the most instructive case is the Northern District of California's decision in *Sky Valley Limited Partnership v. ATX Sky Valley, Ltd.* ⁵¹ In that case, Sky Valley claimed that communications it made to a law firm in connection with seeking legal advice were privileged. ATX, however, claimed it was entitled to those communications because it was a co-client with Sky Valley

regarding a development project. At the outset, the *Sky Valley* court observed that whether a client relationship has been established under California law depends on the setting. ⁵²

For instance, California courts generally have an expansive view of "client" when determining whether statements made by a person interviewing a lawyer in connection with seeking legal advice are privileged. California courts have felt a more expansive view is appropriate in that context because of society's interest in encouraging people to seek legal advice. In other areas, California courts have employed a more constrained analysis when considering whether a party is a "client." ⁵³

One of those areas is the co-client exception. According to the *Sky Valley* court, California courts have been reluctant to simply consider—as the Trustee seems to suggest is appropriate here—whether two people have sought legal advice from a particular lawyer in deciding whether the co-client exception applies:

[C]ourts have not been satisfied simply to ask whether each of two persons sought legal service or advice from a *465 particular lawyer in her professional capacity. Instead, the courts have focused on whether it would have been reasonable, taking into account all the relevant circumstances, for the person who attempted to invoke the joint client exception to have inferred that she was in fact a "client" of the lawyer. ⁵⁴

The *Sky Valley* court then outlined a number of factors courts should consider in deciding whether the co-client exception applies.

Those factors can be broken down into two categories: (i) the relationship between the attorney and the client seeking to invoke the co-client exception; and (ii) the relationship between the co-clients. Factors relating to the relationship between the attorney and the client seeking to invoke the co-client exception include: the conduct of the attorney and that client; the reason the lawyer and that client communicated; the substance of the communications between the lawyer and that

client; the capacity in which the lawyer and that client communicated; whether that client played any role in the decision-making process; and whether that client was free to ignore the attorney's advice. 55

Factors relating to the relationship between the undisputed client and the client seeking to invoke the coclient exception include: the conduct of the parties towards each other; the terms of any contractual relationship between the parties; the existence of any fiduciary relationship between the parties; the extent to which the parties communicated with each other; the extent to which there were private communications between either of the parties and counsel (and the extent to which the other parties knew about those communications); the nature and legitimacy of each party's expectations about its ability to access the other party's communications with counsel; the extent to which the parties' interests were in common and the relationship between those common interests and the parties' communications with counsel; the existence of any actual or potential conflicts between the parties; and, if a dispute arose, whether counsel represented both parties with respect to that dispute. 56 The Sky Valley Court applied those factors and ultimately determined that the co-client exception did not apply in that case.

In refusing to apply the co-client exception, the court primarily focused on three factors. First, the parties were on "decidedly unequal footing with respect to contractually based rights of access to information from one another." Second, the parties were not fiduciaries. Third, there was more than a de minimis possibility that a conflict would arise between the parties. ⁵⁷ According to the court, the existence of a contractual right of access to information and a fiduciary relationship were the central factors in cases previously upholding the applicability of the co-client exception. ⁵⁸

In fact, those two factors—the right to access information and the existence of fiduciary relationship—are at the core of the co-client exception:

The principal purposes of the joint client exception to the privilege ... are (1) to prevent unjustifiable inequality in access to information necessary to resolve fairly the disputes that arise between parties

who were in the past joint clients—when the disputes relate to matters that *466 were involved in the joint representation, and (2) to discourage abuses of fiduciary obligations and to encourage parties to honor any legal duties they had to share information related to common interests. ⁵⁹

Because those factors were not present in *Sky Valley*, the court declined to apply the co-client exception.

Here, many (if not all) of the factors relating to the relationship between the attorney and the client asserting the co-client exception (the Trustee standing in THMI's shoes) are not present because—as the Receiver correctly notes—THMI was defunct and, as a consequence, had no communications with any of the lawyers. Likewise, many of the factors relating to the relationship between THI (or the Receiver) and THMI appear to weigh in favor of finding that the co-client exception does not apply.

For instance, THI and the Receiver certainly contend that all of the conversations they had with counsel were "private" since there was nobody from THMI around. THI and the Receiver also had private conversations with lawyers that were not representing THMI. THI and the Receiver would undoubtedly argue—and the Court would be inclined to agree—that the absence of any communications weighs in favor of finding that the co-client exception does not apply. But the three most significant factors weigh in favor of finding the co-client exception does apply.

[6] [7] First, THI (or the Receiver) owes THMI a fiduciary duty with respect to defending the wrongful death cases. THI retained counsel to represent THMI in the wrongful death cases based on its obligations—whether real or perceived—under an indemnification provision contained in the stock purchase agreement. THI's (or the Receiver's) indemnification obligation is analogous to an insurer's duty to defend an insured. And in Florida, an insurer's duty to defend rises to the level of a fiduciary duty. ⁶⁰ That duty obligates an insurer to use the same degree of care and diligence in defending an insured as an insurer of ordinary care and prudence should exercise in the management of its own business. ⁶¹

Second, the parties in this case contractually agreed to equal access to information. Under the stock purchase agreement, THI is obligated to make its books and records relating to the wrongful death cases available to THMI. ⁶² There is no limitation on THMI's right to access that information. So it is reasonable to conclude that THI could not have reasonably believed that its litigation files would be kept confidential from THMI.

Third, THI and THMI's interests in the wrongful death cases are nearly-if not completely-identical. In particular, both THI and THMI have the exact same interest in not being held liable for the deaths of the plaintiffs in the wrongful death cases. And the Receiver has said he undertook THMI's defense on behalf of THI because THI and THMI both have the same interest in not being held liable for wrongful death. In fact, the Receiver has expressed his bewilderment that the Trustee does not want him to direct THMI's defense using the same firms he previously retained to represent both parties— *467 given the interests are identical and the defense was at no cost to the estate. 63 The Receiver even conceded in his attorney-client privilege brief that the parties have identical interests in defending the wrongful death cases. 64

The Receiver argues, however, that the Court should overlook the fact that THI's interests are identical to THMI's interests in the wrongful death cases because the Trustee has been adverse to the Receiver since she was appointed in this case. No one could dispute that the Trustee and Receiver are adverse with respect to turnover of the wrongful death litigation files (and just about everything else in this bankruptcy case). But that does not mean THI and THMI's interests in the wrongful death litigation are adverse. In an effort to show they are adverse, the Rydberg firm argues in its brief on the attorney-client privilege that the "Trustee demanded control of the [Webb] appeal solely so she could disavow trial counsel's representation of THMI." 65

Yet, the Rydberg firm notes right before that claim that the "Trustee adopted every argument made by the Receiver, except the one about trial counsel's right to represent THMI." ⁶⁶ In actuality, the Trustee adopted THI's arguments that the trial court deprived the parties of their due process by striking the Rydberg firm's notice

of appearance and leaving the parties without counsel (and, since they are corporations, the ability to appear) at trial—subject to the Trustee's caveat that she could not take a specific position regarding the facts relating to the trial court's decision to exclude counsel from the trial. ⁶⁷ Nothing in the Trustee's brief, as far as the Court can see, "disavows trial counsel's representation of THMI."

And in any case there is no record evidence that the Trustee is somehow "throwing in the towel" on its defense of the wrongful death cases. The Rydberg firm's concession that the Trustee adopted virtually all of the Receiver's arguments on appeal belies that point. At best (or worst), the Receiver and the Trustee disagree over trial strategy in the underlying cases. But that does not change the fact that THI and THMI both have the identical interest in not being held liable for wrongful death. And even if there were some conflicts between THI and THMI regarding strategy, that does not preclude a finding that the co-client exception applies.

In the end, the Court must decide whether—taking into account all the relevant circumstances—it is reasonable for the Receiver to claim he had a reasonable expectation of privacy sufficient to preclude application of the coclient exception. Given that THI and THMI have the same interest in not being held liable for wrongful death, THI (and the Receiver) retained counsel to defend THMI in those cases, THI and the Receiver owe THMI a fiduciary obligation in directing the defense of the wrongful death cases, and THI agreed to make its books and records relating to the wrongful death cases available to THMI, the Court concludes that the Receiver did not have a reasonable expectation of privacy with respect to communications regarding the defense of the wrongful death cases. Accordingly, the Trustee is entitled to invoke the co-client exception with respect to communications *468 relating to the defense of the wrongful death cases. 68

[8] Significantly, allowing the Trustee to invoke the coclient exception with respect to those communications is—contrary to the Receiver's assertion—completely consistent with public policy. As the *Sky Valley* court observed, the purpose of the co-client exception is to (i) prevent unjustifiable inequality in access to information necessary to fairly resolve disputes that arise between parties who were in the past joint clients; and (ii) to discourage abuses of fiduciary obligations and to

encourage parties to honor any legal duties they had to share information related to common interests. ⁶⁹

Here, the Court has ruled that the Trustee has the right to control THMI's defense in the wrongful death cases. The Trustee has since retained new counsel for THMI. THMI's new counsel cannot be expected to prosecute the pending appeals in *Nunziata* or *Webb* or defend the remaining wrongful death cases without access to prior counsel's files. Nor should THI or the Receiver be permitted to use access to the litigation files as leverage for the Receiver to regain control of THMI's defense in the wrongful death cases. To allow THI (or the Receiver) to deny the Trustee access to the litigation files would ultimately deprive THMI's of its contractual right to access that information and sanction an abuse of THI's fiduciary obligations to THMI.

Moreover, the Trustee reasonably believes that the estate may have a breach of fiduciary duty claim against THI and the Receiver for directing THMI's counsel to withdraw from the wrongful death cases (and possibly a malpractice claim against the law firms for actually withdrawing). And the only way for the Trustee to investigate those potential claims is to review the litigation files. Yet, the Trustee will be denied access to her sole—or at least primary—means of investigating those claims if she cannot invoke the co-client exception. So depriving THMI access would thwart the Trustee in fulfilling her statutory duties.

The co-client exception only applies to communications about the defense of the wrongful death cases

[9] The same is not true for communications between THI (or the Receiver) and counsel for THI and THMI regarding matters unrelated to the defense of the wrongful death cases. That is not to say the Trustee would not benefit from having communications regarding a number of other issues, such as the Receiver's strategy (or the strategy of other parties) for: opposing collection in the *Jackson* proceedings supplementary; opposing turnover of the litigation files; or retaining control of THMI's defense in the wrongful death cases. She may even be able to develop some causes of action on behalf of the estate from reviewing those communications. But depriving the Trustee of those communications would not thwart the purpose behind the co-client exception.

That is because THMI does not have any contractual right to access information *469 related to those matters (or any matters unrelated to the defense of the wrongful death cases). Nor do THI and the Receiver owe THMI a fiduciary duty with respect to anything other than the defense of the wrongful death cases. So denying the Trustee access to information unrelated to the wrongful death cases would not result in an unjustifiable inequality of access to information or encourage abuses of fiduciary obligations. For all of those reasons, the Court concludes that the Receiver had a reasonable expectation that his communications with THI and THMI's lawyers regarding matters other than the wrongful death cases would be confidential. As a consequence, the Trustee's invocation of the co-client exception is limited to communications relating to the defense of the wrongful death cases.

Communications between Fundamental Administrative Services and counsel defending THI and THMI are included within the co-client exception

Since the Trustee (standing in THMI's shoes) is entitled to invoke the co-client exception, that means she is entitled to any communications between THI (or the Receiver) and any of the law firms defending THI and THMI in the wrongful death cases. The Trustee is also entitled to invoke the co-client exception with respect to any communications between Fundamental Administrative Services and the law firms representing THI and THMI relating to the defense of the wrongful death cases.

[10] [11] Ordinarily, communications between Fundamental Administrative Services and the law firms representing THI and THMI would not be privileged. That is because Fundamental Administrative Services is not a client of those firms. But there is no question that the attorney-client privilege extends not only to the lawyer giving advice but to any persons assisting the lawyer in providing legal services. ⁷¹ It also extends to the client's inhouse counsel and agents. ⁷²

[12] Here, the record reflects that Fundamental Administrative Services provided "back office administrative services," including in-house counsel services, to nursing facility operators nationwide, including THI. And those services included facilitating the defense of the wrongful death cases on behalf of THI

(and the Receiver) and THMI. Moreover, the Receiver specifically argues that Fundamental Administrative Services acted as its agent with respect to the wrongful death cases. As a consequence, those communications between Fundamental Administrative Services and the lawyers defending THI and THMI are protected from disclosure to third parties but available to THMI under the co-client exception since Fundamental Administrative Services was facilitating THMI's defense as well as THI's defense.

[13] [14] The analysis is slightly different, however, with respect to communications between THI (or the Receiver) and Fundamental Administrative Services. THI and the Receiver have proffered evidence that Fundamental Administrative Services effectively served as THI's inhouse counsel. Under federal law, the attorney-client privilege "attaches where the client is a corporation, and where the attorney is in-house counsel." Therefore, *470 communications strictly between THI (or the Receiver) and Fundamental Administrative Services are not subject to the co-client exception.

The common interest doctrine

But what about communications among the parties to the January 5, 2012 settlement agreement and their counsel relating to the wrongful death cases or other matters? ⁷⁴ In some cases, lawyers for THI and THMI may have had conversations with the lawyers representing Fundamental Long Term Care Holdings, LLC. Or perhaps parties to the *Jackson* proceedings supplementary may have had conversations among themselves. Ordinarily, those communications would not be privileged because they are not confidential communications between a lawyer and client. Nevertheless, the Receiver says those communications between the parties to the settlement agreement (and their lawyers) are protected from disclosure under the common interest doctrine. ⁷⁵

[15] The common interest doctrine—like the co-client exception—is typically referred to as an exception to the attorney-client privilege waiver rule rather than a privilege itself. ⁷⁶ The "need to protect the free flow of information from attorney to client logically exists whenever multiple clients share a common interest about a legal matter." ⁷⁷ The common interest doctrine protects that free flow

of information by providing that "clients and their respective attorneys sharing common litigation interests may exchange information freely among themselves without fear that by their exchange they will forfeit the protection of the [attorney-client] privilege." ⁷⁸

There is some dispute over how similar the interests must be for the common interest doctrine to apply. ⁷⁹ In *Duplan Corp. v. Deering Milliken, Inc.*, for example, the court suggested the legal interests must be identical. The Restatement (Third) of the Law Governing Lawyers, by contrast, says the interests "need not be entirely congruent." ⁸⁰ In *In re Teleglobe Communications*, the court, in explaining the split of authority, noted it need not resolve that dispute. ⁸¹ Here, too, the Court need not decide how similar the interests must be.

[16] That is because the interests of all of the parties to the January 5, 2012 settlement agreement are identical with respect to the defense of the wrongful death cases. After all, the parties to the settlement agreement are all defendants in the *Jackson* proceedings supplementary. And *471 there would be no proceedings supplementary without any underlying liability for wrongful death. For that reason, all of the parties to the settlement agreement would, for instance, have an identical interest in vacating the *Jackson* judgment. They would all likewise have an identical interest in appealing the *Nunziata* and *Webb* judgments. Of course, THMI shares an identical interest in avoiding liability for wrongful death.

[17] As a consequence, the common interest doctrine protects communications between parties to the settlement agreement from being disclosed to third parties, but it cannot be used to protect those communications from disclosure to THMI to the extent the relate to the defense of the wrongful death cases. While the general rule is that parties that share information under the common interest doctrine cannot invoke the attorney-client privilege in subsequent adverse litigation between them, if there are multiple members that share information, and only two become adverse, the party seeking communications is entitled to all communications between members with common interests—not just communications with the adverse party. 82

The Court cannot conceive of any basis for an attorney for THMI to refuse to share communications he or

she received from other parties with identical interests in the wrongful death cases. The Receiver, however, suggests one: he says that the communications between the parties to the settlement agreement are, for the most part, subsumed under a joint defense agreement. But the Court concludes that the joint defense agreement cannot be used to deny the Trustee access to communications relating to the defense of the wrongful death cases for several reasons.

For starters, the Receiver does not appear to have ever disclosed a copy of the joint defense agreement. The Court cannot very well refuse the Trustee access to communications she would otherwise be entitled to based solely on an agreement that the Court has never seen. Moreover, according to the Receiver's brief, THMI is a party to the joint defense agreement. The Receiver's own brief says the agreement was signed by Fowler White, the Rydberg firm, Wilkins Tipton, and Wisler Pearlstine—all counsel for THI and THMI—and that those firms signed the agreement "for themselves and their clients." 83 Finally, and most importantly, the joint defense agreement is unenforceable here.

Two years ago, the bankruptcy court for the Southern District of Florida considered the enforceability of joint defense agreements in bankruptcy in *In re Ginn–LA St. Lucie, Ltd.* ⁸⁴ There, like here, the parties had entered into an agreement that purportedly contracted around the general rule prohibiting co-clients or parties with common interests from invoking the attorney-client privilege in subsequent adverse litigation between them. ⁸⁵ The joint defense agreement, which was signed six months before the petition date, expressly stated that it was entered into in contemplation of bankruptcy. ⁸⁶

The *Ginn–LA St. Lucie* court initially noted that the Restatement (Third) of the Law Governing Lawyers was the only authority *472 permitting parties to circumvent the well-established co-client exception. According to the Restatement, co-client communications are not privileged in subsequent adverse litigation between the parties "[u]nless the co-clients have agreed otherwise." ⁸⁷ The Reporter's Note, however, observed that there was no direct authority for that proposition. So the *Ginn–LA St. Lucie* court looked to the only case that had previously considered the issue—*In re Mirant.* ⁸⁸

In *Mirant*, the same law firm represented the debtor and its former parent in connection with a transaction in which the parent divested itself of its interest in the debtor. The parties had signed a "protocol for legal representation" prohibiting the parties from sharing confidential information even if they later became adverse to each other. ⁸⁹ About two years after the transaction was closed, the debtor filed for chapter 11 bankruptcy and sought documents relating to the transaction as part of its investigation into potential claims against the former parent.

While acknowledging that the attorney-client privilege "was meant to foster open communications between the attorney and client," the *Mirant* court recognized that the privilege must give way when necessary to promote an important public policy. According to the *Mirant* court, allowing the parent company to invoke the attorney-client privilege to deny the debtor access to documents related to the corporate transaction would thwart the goals of bankruptcy law. ⁹⁰ After all, the debtor was acting as a fiduciary for the benefit of its creditors, so it was important for both the creditors and the public that the parent company's liability be thoroughly explored. ⁹¹

Applying the rationale from *Mirant*, the *Ginn–LA St. Lucie* court likewise concluded that enforcing the joint defense agreement would offend public policy. ⁹² According to the court, enforcement of the joint defense agreement in that case would thwart the trustee's statutory duties:

While the [joint defense agreement] might indeed further the presumed intent of the parties, its enforcement in this matter risks frustrating the Trustee's statutory duty to investigate the financial affairs of the Debtors while providing special protection to those who allegedly controlled the Debtors prior to the Petition Date. The ability of such provisions to shield wrongdoers at the expense of a debtor's creditors renders their enforcement in bankruptcy proceedings against public policy. ⁹³

The same policy considerations that exist in *Mirant* and *Ginn–LA St. Lucie* exist in this case. The Trustee has a statutory duty to investigate potential claims against THI and the law firms that represented THI and THMI in the wrongful death cases. It is, of course, important to

the creditors that those potential claims be thoroughly investigated. And it is just as important—if not more so —that the Trustee be able to direct the defense of THMI. The ability of the Trustee to fulfill those *473 statutory duties is of paramount importance to the integrity of the bankruptcy system. Yet, the potential targets of the breach of fiduciary duty and malpractice claims seek to invoke the joint defense privilege (as memorialized in their joint defense agreement) to deny the Trustee access to (i) the only information available to investigate potential claims against them; and (ii) information that is critically necessary to direct THMI's defense in the wrongful death cases. Because enforcing the joint defense agreement would be contrary to the goals of bankruptcy, the Court concludes that the Receiver cannot rely on the joint defense agreement to deny the Trustee access to communications related to the defense of the wrongful death actions.

The lawyers cannot assert the work product doctrine

[18] The co-client exception and common interest doctrine analysis governing the attorney-client privilege applies with equal force to the work product doctrine. Under the Court's attorney-client privilege analysis, the Trustee would ordinarily be entitled to the litigation files containing the work product of the lawyers representing THI and THMI. But the Receiver, as well as Christine Zack and Kristi Anderson (both in-house counsel for Fundamental Administrative Services) raise another issue: they claim the individual attorneys—and not THMI—can invoke that work product doctrine to avoid turning over their litigation files to the Trustee (standing in the shoes of their former client). 94

As a preliminary matter, there seems to be some dispute about whether state or federal law applies. The Receiver, on the one hand, contends that state law governs application of the work product doctrine in this case. ⁹⁵ The Trustee, on the other hand, says federal law governs. ⁹⁶ And Ms. Zack and Ms. Anderson both argue under federal law. ⁹⁷ The Court, however, need not decide whether state or federal law governs application of the work product doctrine because the answer is the same in either case.

The sole authority for the Receiver's claim that the work product doctrine belongs to the attorney under state law is Donahue v. Vaughn. 98 The Receiver cites that case for the proposition that "there is no duty upon a private attorney to give any of his files to a client, save documents which are solely those of the client and held by the lawyer." 99 While the Vaughn court, indeed, says that a private attorney has no obligation to give any of his or her files to a client, the court there was not addressing whether the attorney or client holds the work product privilege. 100 Rather, it was addressing whether an attorney has to give his client a copy of his file for free. That case does not say anywhere that an attorney can invoke the work product doctrine to avoid turning over his or her files if the client is willing to pay for the copies. ¹⁰¹ So Florida law does not *474 permit an attorney to refuse to turn over files to a client willing to pay for them.

Ms. Zack, however, says there are some federal court decisions to that effect. Ms. Zack, for instance, cites *United Steelworkers of America v. Ivaco* for the proposition that the "work-product doctrine belongs to both the client and attorney" and that "a waiver of the privilege by the client does not deprive the attorney of his own privilege." ¹⁰² She likewise cites *QBE Insurance Corp. v. Griffin* for the proposition that "the work-product privilege is shared between the attorney and the client" and that "an attorney may contest disclosure [of work product] even in the face of the client's waiver." ¹⁰³ But neither of those decisions involves an attorney invoking the work product doctrine to refuse turning over his or her files to a client. ¹⁰⁴

And in any case, there is a more fundamental problem for the Receiver, Ms. Zack, and Ms. Anderson: the Trustee has stepped into the shoes of THMI, and numerous bankruptcy cases have concluded that an attorney cannot withhold documents against their former clients based on the work product privilege. ¹⁰⁵ For instance, in *Ginn–LA St. Lucie*, Judge Hyman stated that "the majority view [is] that upon termination of the attorney-client relationship, where no claim for unpaid legal fees is outstanding, the client is presumptively accorded full access to the entire attorney's file." ¹⁰⁶

Even more instructive is the court's analysis in *In re Equaphor*. ¹⁰⁷ In that case, Whiteford, Taylor & Preston, which acted as the debtor's corporate counsel, represented

the debtor and three of its officers who had been named as defendants in a shareholder derivative suit. The debtor had only been named as a nominal defendant in that suit. Four months after the shareholder derivative suit was brought, the debtor filed for chapter 7 bankruptcy, and the law firm representing it (and the individual officers) in the shareholder derivative suit withdrew. The chapter 7 trustee later sought turnover of the litigation files from the law firm representing the debtor in the shareholder derivative suit.

Of course, the law firm representing the debtor and individual officers objected based on the work product privilege. The law firm contended that its notes and internal memoranda were work product and not part of the client files that the Trustee was entitled to. The court agreed that *475 attorney opinion work product (such as the attorney's mental impressions and theories) "enjoys nearly absolute protection from disclosure under the rules of discovery." ¹⁰⁸

Nevertheless, the court ordered the law firm to turn over the files because courts are uniform in holding that an attorney cannot use the work product privilege to deny a client access to its files:

[T]his is not a discovery dispute in the ordinary sense of the term. It is a motion to compel the turnover of the law firm's files under 11 U.S.C. § 542(e) to the party who now stands in the shoes of the former client, the Debtor. Under these circumstances, the courts have been uniform in holding that the work product doctrine does not prevent the turnover of the files. [The law firm] will be ordered to turn over its entire files, notwithstanding any claim or assertion of work product. ¹⁰⁹

According to Ms. Zack, *Equaphor* (and the cases cited in it) are distinguishable because the court in that case was not ordering turnover of a law firm's files to an adverse party. ¹¹⁰

Ms. Zack's argument, however, confuses the issue. To be sure, the Trustee is currently adverse to Ms. Zack in

two cases pending in federal district court (a malpractice action and an action for the unlicensed practice of law). And there are cases for the proposition that the "work product rule is designed to protect the lawyers' work from his litigation adversary." ¹¹¹ But that refers to one party seeking to obtain his adversary's work product generated in the same case. Here, the Trustee is seeking work product generated during the wrongful death cases. THMI and Ms. Zack were not adverse during the wrongful death cases. The Trustee is not seeking to obtain work product Ms. Zack or her attorneys have generated in the pending federal court cases.

[19] And that is what the work product doctrine seeks to protect against—not disclosure of work product generated in a previous case:

The purpose of shielding attorney work product from disclosure is to protect "the adversarial process by providing an environment of privacy in which a litigator may creatively develop strategies, *476 legal theories, and mental impressions outside the ordinary realm of federal discovery provisions, thereby insuring that the litigator's opponent is unable to ride on the litigator's wits." ¹¹²

Since that interest is not implicated here, neither the law firms nor Fundamental Administrative Services' in-house counsel (Ms. Zack and Ms. Anderson) have the right to invoke the work product doctrine to deny the Trustee access to the litigation files for the wrongful death cases.

Besides, the work product doctrine does not apply for another reason. THI and the Receiver retained counsel for THMI under an indemnification agreement. Under that indemnification agreement, THI is obligated to provide THMI access to the books and records relating to the wrongful death litigation files and cooperate with THMI. As the court in *Abbott Laboratories v. Alpha Therapeutic Corp.* recognized, those cooperation clauses are designed to assist parties in determining their respective rights. ¹¹³ Now that the Trustee (standing in THMI's shoes) needs the litigation files to direct THMI's defense of the wrongful death cases and evaluate potential claims on behalf of the estate, it would be unfair to allow THI (or its attorneys) to invoke the work product doctrine.

The Trustee cannot disclose the attorneyclient communications or work product

One consistent theme throughout this bankruptcy case has been the Receiver's claim—and the claim by others—that the Trustee is in cahoots with the creditors (the plaintiffs in the wrongful death cases). The theory goes that the Trustee wants THI and THMI to be liable for hundreds of millions—if not billions—of dollars in judgments because without any judgments against THI and THMI there are no claims against the Debtor, and without claims against the Debtor, there is no bankruptcy case. And without this case, the Trustee cannot collect a potentially enormous statutory fee. The Receiver fears that the Trustee will potentially sabotage THI's defense by sharing the attorney-client communications and work product with the wrongful death plaintiffs.

[20] The Trustee, however, is prohibited from disclosing the attorney-client communications or work product to any party that would result in the privileges being destroyed. That is because the Trustee is obtaining the communications under the co-client exception and common interest doctrine, and waiver of the privilege under those circumstances requires consent of all of the parties who share the privilege. ¹¹⁴ Courts that have granted parties access to attorney-client communications or work product under the co-client exception or common interest doctrine have seen fit to prohibit those parties from disclosing the communications or work product to third parties. ¹¹⁵ This Court will do the same here.

Conclusion

According to an ancient Greek legend, King Gordius tied his ox-cart to a post using an intricate knot. An oracle prophesied that whoever untied the knot would be *477 the future king of Asia. Over time, many individuals tried and failed to untie the knot. In 333 B.C., Alexander the Great eventually happened upon the knot and, after unsuccessfully attempting to untie it, sliced it in half with his sword. Today, the phrase "Gordian knot"—derived from that ancient Greek legend—refers to an "exceedingly complicated problem." 116

At first glance, the privilege issues in this case appear to be a classic Gordian knot. On the one hand, the Trustee needs communications between THI and counsel defending THI and THMI in the wrongful death cases (as well as the law firms' litigation files) so that her new lawyers can prosecute appeals in *Nunziata* and *Webb* and direct THMI's defenses in the remaining cases. On the other hand, THI and the Receiver say—and the Court does not doubt—that they subjectively believed their communications to the law firms would be private because THMI was defunct. And in-house counsel for Fundamental Administrative Services fear their work product will be used against them in pending malpractice and unlicensed practice of law claims. But unlike the bold action required by Alexander the Great, the Court here simply resorts to public policy to solve the problem.

[21] Although the attorney-client privilege fosters an important public interest of full and frank disclosure between attorneys and their clients, it is not absolute. 117 Here, as is often the case, invocation of the privilege would impede the search for truth. And because the need to investigate the truth is far more acute in bankruptcy than is any concern for attorney-client communications, the privilege must give way. The court in *Burden v. Church of Scientology of California* recognized just that in a slightly different context (involving the identity of a client):

As between the social policies competing for supremacy, the choice is clear. Disclosure should be made if we are to maintain confidence in the bar and in the administration of justice. ¹¹⁸

Here, allowing THI and the Receiver to invoke the attorney-client privilege with respect to communications relating to the defense of the wrongful death cases would thwart the Trustee's statutory duties. Allowing Ms. Zack and Ms. Anderson (or the other firms representing THI and THMI) to invoke the work product privilege to avoid turning over the litigation files for those cases would do the same.

Accordingly, for the reasons set forth above, the Court concludes that the Trustee is entitled to invoke the co-client exception to obtain (i) any communications between THI (and the Receiver) and the law firms representing THI and THMI in the wrongful death cases; (ii) any communications between Fundamental Administrative Services (including Ms. Zack and

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Ms. Anderson) and the law firms representing THI and THMI (but not communications solely between Fundamental Administrative Services and the Receiver); (iii) communications between the parties to the settlement agreement (and their lawyers) with respect to the defense of the wrongful death cases; and (iv) copies of the litigation files (including any attorney work product) for the wrongful death cases.

The Trustee, however, is not entitled to any communication or litigation files relating *478 to defense of the proceedings supplementary, opposition to the Trustee's efforts to obtain the litigation files, the Trustee's

efforts to control the defense of THMI, or other issues unrelated to the defense of the wrongful death cases. Nor is the Trustee (or her attorneys) permitted to share any of the information they obtain under the co-client exception with any third party that would destroy the attorney-client and common interest privilege, common interest doctrine, and work product doctrine (such as the plaintiffs in the wrongful death cases or their attorneys).

All Citations

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Footnotes

- At least a part of the Court's analysis in this Memorandum Opinion relies on the existence of an indemnification agreement between THI and THMI under a stock purchase agreement. The Court understands that THI Holdings, LLC (THI's parent company) and the Receiver now dispute that they are obligated to indemnify THMI under the stock purchase agreement. There can be no serious doubt, however, that the Debtor, Fundamental Administrative Services, THI, and the Receiver all previously operated under the assumption that THI was obligated to indemnify THMI under the stock purchase agreement. Doc. Nos. 105, at p. 5; 109 at p. 17; 204 at pp. 9–10; 318 at pp. 27–29; 373 at p. 59; 402 at pp. 127–29; 599 at p. 124. Since the applicability of the co-client exception is based on whether the Receiver had an *objectively* reasonable belief that his communications to counsel would be kept private from THMI, the Receiver is estopped from disputing the indemnification obligation for these purposes. But the Court is not making any findings regarding the enforceability of that agreement for purposes of the separate adversary proceeding that has been filed, styled *Scharrer*, et al. v. THI Holdings, LLC, Adv. Pro. No. 13–ap–00155.
- 2 Although the stock sale closed in late March 2006, the actual stock purchase agreement is dated February 28, 2006.
- 3 Alan Grochal is currently THI's court-appointed receiver.
- 4 Jackson was filed on July 30, 2004.
- 5 Nunziata was filed on December 23, 2005; Jones was filed on March 20, 2006.
- 6 Webb was filed on June 16, 2006; Sasser was filed on September 6, 2006.
- 7 Townsend was filed January 29, 2009.
- 8 Schutt Schmidt also represented THI and THMI in the *Townsend* case. But that case was not filed until after THI went into receivership.
- 9 It also appears that Fudge & McArthur withdrew as counsel in the *Jones* case and that Schutt Schmidt withdrew in the *Townsend* and *Webb* cases.
- Those entities (or individuals) included: the Debtor; Murray Forman; General Electric Capital Corporation; GTCR Golder Rauner LLC; Fundamental Administrative Services, LLC; Fundamental Long Term Care Holdings, LLC; GTRCR Fund VI, LP; Leonard Grunstein; Troutman Sanders, LLP; Rubin Schron; THI of Baltimore, Inc.; Ventas, Inc.; and Ventas Realty Limited Partnership.
- THI had previously filed an action in Miami–Dade County to domesticate its receivership order. That action was styled *Trans Health, Inc. v. Bonnie Creekmore*, Case No. 09–11513–CA–20. In the *Creekmore* case, the Receiver sought to stay the *Jackson, Nunziata, Sasser, Townsend,* and *Webb* cases. The state court apparently denied the Receiver's request. The *Jackson* plaintiff later moved for a determination in the *Creekmore* case that it had timely filed a claim in the Maryland receivership proceeding.
- Doc. No. 6. The Debtor says it did not respond to the involuntary petition because it did not receive proper notice. That issue, however, is not relevant to the current issues before the Court. Suffice it to say, the Court entered an order for relief.
- 13 Doc. Nos. 14, 23 & 105.
- 14 Doc. No. 34.
- 15 Doc. No. 244.

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- 16 Doc. Nos. 244 & 286.
- Doc. Nos. 268, 269, 354, 360, 363, 383, 384, 385 & 388. The Receiver and law firms also raised two procedural issues: First, they argued that contempt or other sanctions for failure to comply with the Court's show-cause orders was inappropriate because those orders were not directed at any particular party and, according to the Court, could not be enforced without the Trustee initiating a contested matter. Second, the parties contended that an Omnibus Discovery Order entered by the Court discharged the Court's previous show-cause orders.
- The Court also considered whether THMI had the right to assert the attorney-client privilege. The Court initially concluded that THMI no longer had an attorney-client privilege to assert because it was defunct and administratively dissolved. But the Court went on to consider who had the right to control THMI's defense. And as part of that analysis, the Court assumed the attorney-client privilege could be raised.
- 19 In re Fundamental Long Term Care, Inc., 2012 WL 4815321 (Bankr.M.D.Fla. Oct. 9, 2012).
- 20 Id. at *8 (citing Wofford v. Wofford, 129 Fla. 445, 176 So. 499, 504 (1937)).
- 21 *Id.*
- 22 Id.
- The Trustee's production requests and the objections to them are the subject of various motions that the Court has taken under advisement. Doc. Nos. 444, 451, 467, 472, 575, 591 & 631.
- The issues relating to the attorney-client privilege, common interest doctrine, and work product doctrine have been thoroughly briefed by the parties. In fact, the Trustee, Receiver, law firms, and creditors have filed a total of 34 memoranda and cited over 80 cases for the Court's consideration.
- This Court has jurisdiction over this contested matter under 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (E) & (O).
- 26 Doc. No. 613 at 3-6.
- 27 Doc. No. 610 at 5–6.
- 28 Doc. No. 686 at p. 58, l.25-p. 59, l.5.
- 29 The Florida Bar v. King, 664 So.2d 925, 926 (Fla.1995).
- 30 *Id.* at 926–27.
- 31 Doc. No. 624–2.
- 32 *Id.*
- 33 Doc. No. 613 at 5.
- 34 Id. (citing Zych v. Jones, 84 III.App.3d 647, 40 III.Dec. 369, 406 N.E.2d 70 (1980)).
- 35 Zych, 40 III.Dec. 369, 406 N.E.2d at 74.
- 36 Id.
- 37 Id.
- THMI must have consented to the lawyers THI initially retained to defend THMI before it was sold to the Debtor because the Receiver concedes THMI had an attorney-client relationship with the law firms defending it before 2006. There would be no reason THMI would have to consent to those lawyers continuing to represent it after it was sold to the Debtor. So that leaves for the Court's consideration THMI's relationship with the law firms that were retained by THI or the Receiver after THMI was sold.
- 39 Doc. Nos. 187–2; 624–1 at § 6(c); 624–2 & 624–3.
- 40 Doc. Nos. 187-2; 624-2 & 624-3.
- 41 *Id.*
- 42 Doc. No. 613 at 5.
- 43 U.S. Specialty Ins. Co. v. Burd, 833 F.Supp.2d 1348, 1353 (M.D.Fla.2011) (explaining "it is clear that under Florida law, a tripartite relationship normally exists between the insurer, the insured, and the lawyer retained to represent the insured"); Hartford Ins. Co. of the Midwest v. Koeppel, 629 F.Supp.2d 1293, 1299 (M.D.Fla.2009) (explaining that decisions in most jurisdictions "reflect the view that a 'tripartite relationship' exists among the insurer, insured, and counsel, with both insurer and insured as co-clients of the firm in the absence of a conflict of interest") (quoting Gen. Sec. Ins. Co. v. Jordan, Coyne & Savits, LLP, 357 F.Supp.2d 951, 956 (E.D.Va.2005)); Pine Island Farmers Coop v. Erstad & Riemer, P.A., 649 N.W.2d 444, 449 (Minn.2002) (explaining "it is clear that in an insurance defense scenario, defense counsel has an attorney-client relationship with the insured").
- 44 Liberty Mut. Fire Ins. Co. v. Kaufman, 885 So.2d 905, 908 (Fla. 3d DCA 2004).

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- 45 Doc. No. 686 at p. 58, I.25-p. 59, I.5.
- 46 In re Ginn-LA St. Lucie, Ltd., 439 B.R. 801 (Bankr.S.D.Fla.2010).
- 47 Transmark, USA, Inc. v. State Dep't of Ins., 631 So.2d 1112, 1116–17 (Fla. 1st DCA 1994). Ashcraft & Gerel v. Shaw, 126 Md.App. 325, 728 A.2d 798, 812–13 (1999).
- 48 Doc. No. 613 at 7.
- 49 Doc. No. 621 at 7 (citing Ashcraft, 728 A.2d at 812–13).
- 50 Ashcraft, 728 A.2d at 812–13.
- 51 Sky Valley Ltd. P'ship v. ATX Sky Valley, Ltd., 150 F.R.D. 648 (N.D.Cal.1993); see also FDIC v. Ogden Corp., 202 F.3d 454, 461–62 (1st Cir.2000).
- 52 Sky Valley, 150 F.R.D. at 651.
- 53 *Id.*
- 54 *Id.*
- 55 *Id.* at 652.
- 56 *Id.* at 652–53.
- 57 *Id.* at 659–663.
- 58 *Id.*
- 59 Id. at 653.
- 60 U.S. Fire Ins. Co. v. Hayden Bonded Storage Co., 930 So.2d 686, 691 (Fla. 4th DCA 2006) (explaining that "an insurer's duty to defend rises to the level of a fiduciary duty").
- 61 Id.
- 62 Doc. No. 624-1 at § 6(c)(vi)(c).
- 63 Doc. No. 402 at p. 126, l.8-p. 129, l.3.
- 64 Doc. No. 613 at 8.
- 65 Doc. No. 610 at 9.
- 66 Id. (emphasis added).
- 67 Doc. No. 610–2.
- Those law firms include: Fowler White; Fudge & McArthur; Mancuso & Dias; Quintairos Prieto; Romaguerra Baker; the Rydberg firm; Schutt Schmidt; Wilkins Tipton; and Wisler Pearlstine.
- 69 Sky Valley Ltd. P'ship v. ATX Sky Valley, Ltd., 150 F.R.D. 648, 653 (N.D.Cal.1993).
- The Court, of course, is not finding that such claims exist or have merit. If the Receiver's allegations regarding the conduct by Wilkes & McHugh are true, then no such claims may exist. But based on the record before the Court, those claims are certainly plausible.
- 71 Miller v. Haulmark Transp. Sys., 104 F.R.D. 442, 445 (E.D.Pa.1984); Liberty Mut. Fire Ins. Co. v. Kaufman, 885 So.2d 905, 909 (Fla. 3d DCA 2004).
- 72 Kaufman, 885 So.2d at 909.
- 73 Shipes v. BIC Corp., 154 F.R.D. 301, 304 (M.D.Ga.1994) (citing Upjohn Co. v. United States, 449 U.S. 383, 390, 101 S.Ct. 677, 66 L.Ed.2d 584 (1981) and 8 Charles A. Wright & Arthur R. Miller, Federal Practice & Procedure § 2017 at 135–36 (1970)).
- The parties to the settlement agreement are: the Receiver; General Electric Capital Corporation; Fundamental Administrative Service, LLC; THI of Baltimore, Inc.; Fundamental Long Term Care Holdings, LLC; Murray Forman; Leonard Grunstein; Rubin Schron; Ventas, Inc.; GTCR Golder Rauner, LLC; GTCR Fund VI, LP; GTCR Partners VI, LP; GTCR VI Executive Fund, LP; GTCR Associates VI; Edgar D. Jannotta, Jr.; and THI Holdings, LLC.
- 75 Doc. No. 613 at 8; Doc. No. 614 at 2–8.
- 76 United States v. Gumbaytay, 276 F.R.D. 671, 673–74 (M.D.Ala.2011).
- 77 United States v. Almeida, 341 F.3d 1318, 1324 (11th Cir.2003).
- 78 In re Indiantown Realty Partners Ltd. P'ship, 270 B.R. 532 (Bankr.S.D.Fla.2001) (quoting Visual Scene, Inc. v. Pilkington Bros., 508 So.2d 437, 440 (Fla. 3d DCA 1987)).
- 79 Teleglobe USA, Inc. v. BCE, Inc. (In re Teleglobe Commc'ns Corp.), 493 F.3d 345, 365 (3d Cir.2007).
- 80 Id. (citing Restatement (Third) of the Law Governing Lawyers § 76 cmt. e.).
- 81 Id.
- 82 Ohio-Sealy Mattress Mfg. v. Kaplan, 90 F.R.D. 21, 29 (N.D.III.1980).

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- 83 Doc. No. 614 at 5 n.1.
- 84 In re Ginn-LA, St. Lucie, Ltd., 439 B.R. 801, 804-05 (Bankr.S.D.Fla.2010).
- 85 Id. at 803.
- 86 Id.
- 87 Id. at 805 (quoting Restatement (Third) Governing Lawyers § 75).
- 88 Id. at 806 (citing In re Mirant, 326 B.R. 646 (Bankr.N.D.Tex.2005)).
- 89 In re Mirant, 326 B.R. at 648.
- 90 Id. at 654 (explaining that "[i]n a bankruptcy case, the need for investigation is far more acute than is any concern for attorney-client communications").
- 91 Id. at 654-55.
- 92 In re Ginn–LA St. Lucie, Ltd., 439 B.R. at 805–07.
- 93 Id. at 805-06.
- 94 Doc. Nos. 612; Doc. No. 625 at 4; Doc. No. 620.
- 95 Doc. No. 620 at 2–3.
- 96 Doc. No. 623 at 3-4.
- 97 Doc. No. 625 at 4–7; Doc. No. 612.
- 98 Doc. No. 620 (citing *Donahue v. Vaughn*, 721 So.2d 356, 357 (Fla. 5th DCA 1998)).
- 99 Id.
- 100 Donahue, 721 So.2d at 356-57.
- 101 *Id.*; see also In re Ginn–LA St. Lucie, Ltd., 439 B.R. 801, 809 (Bankr.S.D.Fla.2010) (explaining that *Donahue* "addressed whether counsel was required to provide documents to a client free of charge").
- 102 Doc. No. 625 at 4 (citing *United Steelworkers of Am., AFL-CIO-CLC v. Ivaco, Inc.,* 2002 WL 31932875, at *6 (N.D.Ga. Jan. 13, 2003)).
- 103 Id. (citing QBE Ins. Co. v. Griffin, 2009 WL 2913478, at *3 (M.D.Ala. Sep. 4, 2009)).
- 104 Ivaco, 2002 WL 31932875, at *6; Griffin, 2009 WL 2913478, at *3.
- 105 See, e.g., In re Ginn-LA St. Lucie, Ltd., 439 B.R. 801, 809 (Bankr.S.D.Fla.2010); In re Equaphor, Inc., 2012 WL 1682583, at *5 (Bankr.E.D.Va. May 14, 2012); see also Spivey v. Zant, 683 F.2d 881, 885 (5th Cir.1982) (holding that "the work product doctrine does not apply to the situation in which a client seeks access to documents or other tangible things created or amassed by his attorney during the course of the representation"); Clark v. Milam, 847 F.Supp. 424, 426 (S.D.W.Va.1994) (explaining that courts have concluded that the work product doctrine does not apply when a client seeks document created for him by his own lawyer); Ashcraft & Gerel v. Shaw, 126 Md.App. 325, 728 A.2d 798, 814–15 (1999) (explaining that "the focus of the work product doctrine is non-disclosure to one's adversary") (emphasis in original).
- 106 In re Ginn–LA St. Lucie, Ltd., 439 B.R. at 809.
- 107 In re Equaphor, Inc., 2012 WL 1682583, at *5.
- 108 Id.
- 109 Id. (citing Foster v. Hill (In re Foster), 188 F.3d 1259, 1272 (10th Cir.1999) (rejecting work product claim in connection with turnover of attorney's files); Loeffler v. Lanser (In re ANR Advance Transp. Co.), 302 B.R. 607, 617 (E.D.Wis.2003) (explaining that to "grant the law firms work product immunity under the circumstances present here would not serve the purpose of the work product doctrine" and that "[c]lients are not adversaries of their lawyers, and the zone of privacy that the work product rule protects was designed to shield lawyers from their opponents, not their clients"); Gardner, Willis, Sweat & Handelman, LLP v. Kelly (In re Golden Grove Pecan Farm), 460 B.R. 349, 352–53 (Bankr.M.D.Ga.2011); Teleglobe Commc'ns Corp. v. BCE, Inc. (In re Teleglobe Commc'ns Corp.), 2006 WL 2568371, at *16 (D.Del. Feb. 22, 2006) (explaining that "[b]ecause work product is created for the benefit of the client, the interest in protecting documents from an adversary is not present in this case"); In re Am. Metrocomm Corp., 274 B.R. 641, 654–55 (Bankr.D.Del.2002)) (internal citations omitted); see also Edna Selan Epstein, The Attorney—Client Privilege & Work Product Doctrine 607 (4th ed. 2001) ("Based on Weintraub, it would seem to follow without question that a trustee-in-bankruptcy for a corporate entity has a right to the work product of the debtor's attorney").
- 110 Doc. No. 625 at 5.
- 111 Id. (citing In re ANR Advance Transp. Co., 302 B.R. 607, 617 (E.D.Wis.2003)).
- 112 Abbott Labs. v. Alpha Therapeutic Corp., 200 F.R.D. 401, 408 (N.D.III.2001) (quoting Certain Underwriters at Lloyds v. The Fid. & Cas. Co. of New York, 1997 WL 769467, at *3 (N.D.III. Dec. 9, 1997)).

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- 113 Id. at 409.
- 114 Durkin v. Shields (In re Imperial Corp. of Am.), 179 F.R.D. 286, 289 (S.D.Cal.1998); Ohio–Sealy Mattress Mfg. v. Kaplan, 90 F.R.D. 21, 29 (N.D.III.1980).
- 115 Ohio-Sealy Mattress, 90 F.R.D. at 32–33.
- 116 http://www.thefreedictionary.com/Gordian+knot.
- 117 Burden v. Church of Scientology of California, 526 F.Supp. 44, 45 (M.D.Fla.1981).
- 118 *Id.*

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In re Fundamental Long Term Care, Inc., 493 B.R. 620 (2013)

493 B.R. 620 United States Bankruptcy Court, M.D. Florida. TAMPA DIVISION

In re: Fundamental Long Term Care, Inc., Debtor.

Case No. 8:11-bk-22258-MGW | June 17, 2013

Synopsis

Background: Following a ruling that Chapter 7 trustee had the right to control the defense of debtor's wholly-owned subsidiary, a defunct and administratively dissolved nondebtor entity, in a series of wrongful death cases that had been brought against subsidiary and its former parent company, which had been represented by the same lawyers, trustee retained new counsel to defend subsidiary and subsequently filed Rule 2004 motions seeking the litigation files from subsidiary's former lawyers so its new counsel could prepare its defense and investigate potential claims against former parent's receiver and against subsidiary's former counsel. Law firms that had represented subsidiary and its former parent objected, citing former parent's attorney-client privilege, the common interest doctrine, and the work product doctrine. The Bankruptcy Court, Michael G. Williamson, J., 489 B.R. 451, ruled that trustee could invoke co-client exception to attorney-client privilege, and objectors moved for reconsideration.

[Holding:] The Bankruptcy Court, Williamson, J., held that alleged unenforceability of indemnification agreement between bankrupt corporate subsidiary and its parent was not "newly discovered evidence," of kind supporting motion for reconsideration.

Motion denied.

West Headnotes (6)

[1] Bankruptcy

Judgment or Order

Parties seeking reconsideration of prior order of court are held to high standard and must demonstrate the following: (1) that controlling law has changed; (2) that newly discovered evidence would merit a different result; or (3) that reconsideration is necessary to correct clear error of law or fact or to prevent manifest injustice.

1 Cases that cite this headnote

[2] Bankruptcy

Privilege

Alleged unenforceability of indemnification agreement between bankrupt corporate subsidiary and its parent was not "newly discovered evidence," inasmuch as bankruptcy court, in holding that trustee of subsidiary's Chapter 7 estate could invoke coclient exception to attorney-client privilege in order to obtain access to otherwise privileged communications between corporate parent and law firms, had specifically contemplated possibility that indemnification agreement might prove unenforceable, nor was it evidence that would "merit a different result," as required to provide basis for reconsideration of prior order allowing trustee to invoke co-client exception to attorneyclient privilege, given that, regardless of enforceability of indemnification agreement, it was reasonable, based on totality of circumstances, for subsidiary to believe that it was client of firms.

1 Cases that cite this headnote

[3] Privileged Communications and Confidentiality

Common interest doctrine; joint clients or joint defense

Test for determining existence of co-client relationship, for purposes of triggering coclient exception to attorney-client privilege, is objective one: courts focus on whether it would have been reasonable, taking into account all the relevant circumstances, for person who attempts to invoke the co-client

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exception to have inferred that he or she was in fact a "client" of attorney.

1 Cases that cite this headnote

[4] Bankruptcy

Privilege

Regardless of whether indemnification agreement between corporate subsidiary and its parent was in fact enforceable, if parties believed that they were bound by agreement, then it would have been reasonable for subsidiary to have inferred that it was, in fact, a client of law firms hired by parent to defend wrongful death cases against the corporations, as required for trustee of corporate subsidiary's Chapter 7 estate to invoke co-client exception to attorney-client privilege in order to obtain access to otherwise privileged communications between corporate parent and law firms.

1 Cases that cite this headnote

[5] Privileged Communications and Confidentiality

Common interest doctrine; joint clients or joint defense

Three most important Sky Valley factors bearing on whether a co-client relationship exists of kind sufficient to trigger coclient exception to attorney-client privilege, i.e., a contractually based right of access to information, existence of fiduciary relationship, and a de minimis possibility that conflict will arise between clients, are not indispensable to the finding of coclient relationship; in the end, regardless of what factors or test they employ, courts are primarily concerned with evaluating whether the party seeking to invoke the co-client exception had objectively reasonable belief, under all the circumstances, that it was attorney's client.

1 Cases that cite this headnote

[6] Bankruptcy

Privilege

Fact that engagement letters between corporate parent and law firms that it retained to defend wrongful death actions against itself and its subsidiary specifically provided that law firms were retained to represent subsidiary in wrongful death actions, that law firms actually made appearances, and advanced legal positions, on subsidiary's behalf, and that law firms coordinated legal strategy for parent and subsidiary was sufficient, in and of itself, to support reasonable belief by subsidiary that it was the law firms' client, and to permit trustee of subsidiary's Chapter 7 estate to invoke coclient exception to attorney-client privilege in order to obtain access to otherwise privileged communications between corporate parent and law firms, regardless of existence or ultimate enforceability of indemnification agreement between corporate parent and subsidiary.

1 Cases that cite this headnote

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Chapter 7

ORDER AND MEMORANDUM OPINION ON MOTION FOR RECONSIDERATION OF PRIVILEGE ISSUES

Michael G. Williamson, United States Bankruptcy Judge

This Court previously ruled in a March 2013 Memorandum Opinion that the Trustee, standing in the shoes of Trans Health Management, Inc. ("THMI"), was entitled *622 to invoke the co-client exception to the attorney-client privilege to obtain certain communications between Trans Health, Inc. ("THI")-THMI's former corporate parent—and lawyers that THI (and, later, its state court receiver) hired to defend THI and THMI in six wrongful death cases. 1 That ruling was based, in part, on the existence of an indemnification agreement between THI and THMI.² Two days after issuing its ruling, this Court heard oral argument from THI Holdings (THI's corporate parent) on a motion to dismiss an adversary complaint filed by the Trustee seeking to enforce that same indemnification agreement. After the Court dismissed the Trustee's adversary complaint, THI's state court receiver -along with Fundamental Administrative Services and Fundamental Long Term Care Holdings-asked this Court to reconsider its Memorandum Opinion. ³

Reconsideration is warranted—as the parties suggest where newly discovered evidence would merit a different result. But here, the Court was aware of the potential unenforceability of the indemnification agreement (i.e., the "newly discovered evidence") at the time it issued its Memorandum Opinion. In fact, it briefly addressed that issue at the outset of the Memorandum Opinion. So that evidence cannot be "newly discovered." And even if it was, it would not merit a different result. For starters, the Court's ruling did not hinge on the existence of the indemnification agreement but rather the parties' belief at the time that it existed and was enforceable. Moreover, the indemnification agreement is not indispensable to the existence of a co-client relationship. It is one factor evidencing a client's objectively reasonable belief that it had an attorney-client relationship. Here, the overwhelming evidence is that it was objectively reasonable under all the circumstances (regardless of the existence of the indemnification agreement) for THMI to believe it had an attorney-client relationship with the law firms defending it in the wrongful

death cases. Accordingly, the motions for reconsideration should be denied.

Background 4

This involuntary chapter 7 case was filed on December 5, 2011. ⁵ Shortly after the order for relief was entered, the Trustee began requesting copies of all the books and records relating to the Debtor and THMI that were in the possession, custody, or control of the THI Receiver, various law firms, and others. ⁶ After a dispute arose between the Trustee, the THI Receiver, *623 and the law firms, this Court concluded that the Trustee was entitled to production of those documents and the right to control THMI's defense in six wrongful death cases that were pending against it and THI. ⁷

The Court later granted the Trustee's motion requesting production of those documents from the various law firms under Rule 2004. The law firms—along with the THI Receiver, Fundamental Administrative Services, Christine Zack, and Kristi Anderson—objected to the production of voluminous documents (in particular, the litigation files from the wrongful death cases) based on the attorney-client, common interest, joint defense, and work product privileges. The Court then invited all of the parties to brief those privilege issues with respect to the litigation files.

In all, the Court received and considered a total of 34 memoranda—which cited to over 80 cases—filed by the parties. The briefing was, to say the least, comprehensive. And all of the relevant parties had an opportunity to be heard on the privilege issues. After reviewing the memoranda and hearing substantial argument from counsel, the Court issued its comprehensive March 2013 Memorandum Opinion. 9

As set forth in the Memorandum Opinion, the Court concluded that the Trustee is entitled to invoke the coclient exception to the attorney-client privilege to obtain (i) any communications between THI (and the THI Receiver) and the law firms representing THI and THMI in the wrongful death cases; (ii) any communications between Fundamental Administrative Services (including Ms. Zack and Ms. Anderson) and the law firms representing THI and THMI (but not communications

solely between Fundamental Administrative Services and the THI Receiver); (iii) communications between the parties to the January 5, 2012 settlement agreement (and their lawyers) with respect to the defense of the wrongful death cases; and (iv) copies of the litigation files (including any attorney work product) for the wrongful death cases. ¹⁰ The Court, however, imposed two important limitations on its rulings.

First, the Court concluded that the Trustee is not entitled to any communications or litigation files relating to the defense of any proceedings supplementary in state court, opposition to the Trustee's efforts to obtain the litigation files, the Trustee's efforts to control the defense of THMI, or other issues unrelated to the defense of the wrongful death cases. ¹¹ Second, the Trustee and her attorneys are not permitted to share any of the information they obtain under the co-client exception with any third party that would destroy the attorney-client, common interest, joint defense, and work product privileges (such as the plaintiffs in the wrongful death cases or their attorneys). ¹²

The THI Receiver and the Fundamental entities now seek reconsideration of the *624 Court's Memorandum Opinion. 13 According to the THI Receiver and the Fundamental entities, the Court's Memorandum Opinion hinges on the existence of an indemnification agreement between THI and THMI, but the THI Receiver and Fundamental entities say the indemnification agreement is unenforceable because it only covers losses relating to nursing homes operated by THI or one of its subsidiaries other than THMI, and the losses here occurred at nursing homes operated by Lyric or Claremont (which are not THI subsidiaries). They say the Court was not aware of that argument until two days after it issued its Memorandum Opinion when THI Holdings argued its motion to dismiss the Trustee's adversary complaint seeking to enforce the indemnification agreement. And, in fact, the Court dismissed the Trustee's adversary complaint against THI Holdings. Based on all of that, the THI Receiver and the Fundamental entities say the Court should reconsider its Memorandum Opinion.

Conclusions of Law

[1] [2] "Parties seeking reconsideration of a prior order are held to a high standard." ¹⁴ Specifically,

a party seeking reconsideration must demonstrate (i) that controlling law has changed; (ii) newly discovered evidence would merit a different result; or (iii) reconsideration is necessary to correct a clear error of law or fact or to prevent a manifest injustice. ¹⁵ The THI Receiver and Fundamental entities claim that newly discovered evidence in this case would merit a different result. ¹⁶

But there is no newly discovered evidence here. The primary argument in support of reconsideration is that the Court discovered that the indemnification agreement was unenforceable for the first time at the hearing on THI Holdings' motion to dismiss the Trustee's adversary complaint seeking to enforce that agreement. That hearing took place on March 21, 2013—two days after the Court issued its Memorandum Opinion. According to the Fundamental entities, the "Court had an opportunity to review and consider for the first time terms of the stock purchase agreement" and that the "Court's new consideration of the contractual language underpinning the alleged indemnity claim undoubtedly affects many explicit conclusions within" the Court's Memorandum Opinion. ¹⁷

In actuality, the Court has reviewed the stock purchase agreement-including the indemnification provisionsnumerous times throughout this case. And it specifically reviewed it in connection with ruling on the privilege issues addressed in its Memorandum Opinion. To be fair, the Court did not hear THI Holdings' oral argument until after the Court entered its Memorandum Opinion. But the same argument it advanced at the March 21 hearing had been raised in its preliminary statement regarding the Trustee's indemnification demand, ¹⁸ and the Court did review that document in preparation for a February 12, 2012 hearing on the Trustee's indemnification demand. So the Court was aware of the argument that the indemnification agreement is potentially *625 unenforceable at the time it issued its Memorandum Opinion.

In fact, the Court specifically addressed that issue in its Memorandum Opinion. The first time it mentioned the indemnification agreement, the Court explained that its ruling depended, at least in part, on the existence of the indemnification agreement and observed that THI Holdings denied it was obligated to indemnify

THMI. ¹⁹ Nevertheless, the Court noted that the actual enforceability of the indemnification agreement was not necessary to the Court's ultimate conclusion. ²⁰

It is also worth noting that the Court did not determine that the indemnification agreement was unenforceable when it dismissed the Trustee's original complaint seeking a declaratory judgment regarding her rights under—and damages for THI Holdings' alleged breach of—that agreement. The Court dismissed the complaint because the Trustee failed to allege sufficient facts giving rise to a plausible claim for relief under that agreement. The Trustee has since amended her complaint, and the Court recently denied THI Holdings' motion to dismiss the amended complaint. At this point, the Court has not determined whether the indemnification agreement is, in fact, enforceable.

And that leads to the second reason reconsideration is not warranted: even if the Court ultimately determines that the indemnification agreement is unenforceable, that fact would not merit a different result in this case. In its Memorandum Opinion, the Court looked to *Sky Valley Limited Partnership v. ATX Sky Valley*, which enumerated a number of factors to consider in determining whether the co-client exception to the attorney-client privilege applies. ²¹ In finding that THI and THMI were co-clients, this Court concluded that the three most significant *Sky Valley* factors—a contractually based right of access to information, the existence of a fiduciary relationship, and a de minimis possibility that a conflict would arise between the clients—were present in this case. ²²

The THI Receiver and Fundamental entities say that the Court's finding with respect to two of those factors—the contractual right to access information and the existence of a fiduciary relationship—is based on the erroneous assumption that a contractual right to indemnification exists. They say there is no right to indemnification because the agreement only obligates THI to indemnify THMI for losses relating to nursing homes operated by THI or one of its subsidiaries other than THMI, and the nursing homes in this case allegedly were operated by Lyric and Claremont (which are not THI subsidiaries). But that argument overlooks two important points.

[3] [4] First, the three *Sky Valley* factors relied on by the Court are proxies for whether (i) THMI reasonably

believed under all the circumstances that it was a client of the law firms defending it in the wrongful death cases; and (ii) the THI Receiver had a reasonable expectation that its communications with counsel defending THI and THMI in the wrongful death cases would be confidential. As the Court explained in its Memorandum Opinion, the test for determining the existence of a co-client relationship for purposes of triggering *626 the co-client exception to the attorney-client privilege is an objective one:

[C]ourts have not been satisfied simply to ask whether each of two persons sought legal service or advice from a particular lawyer in her professional capacity. Instead, the courts have focused on whether it would have been reasonable, taking into account all the relevant circumstances, for the person who attempted to invoke the joint client exception to have inferred that she was in fact a "client" of the lawyer. ²³

If THI and the THI Receiver believed they were bound by the indemnification agreement, then it would have been reasonable for THMI to have inferred it was, in fact, a client of the law firms defending it in the wrongful death cases.

And there can be no serious argument that THI and the THI Receiver believed they were bound by the indemnification agreement until very recently. Otherwise, what is the explanation for the repeated references by THI and the THI Receiver—as well as the Debtor and Fundamental Administrative Services—to THI's obligations under the indemnification agreement when seeking affirmative relief from the various state courts in the wrongful death cases and this Court during the pendency of this bankruptcy case? The fact that the indemnification may turn out to be unenforceable does not somehow change the parties' belief that the agreement was enforceable at the time.

[5] Second, those three factors are not indispensable to the finding of a co-client relationship. They are, as the Court pointed out, the most important of the numerous factors enumerated by the *Sky Valley* court. But other courts have looked to different factors. ²⁵ In the end, courts are—regardless of the factors or

test they employ—primarily concerned with evaluating whether the party seeking to invoke the co-client exception had an objectively reasonable belief (under all of the circumstances) that it was a client. ²⁶

In fact, the First Circuit Court of Appeals did just that in its 2000 decision in *FDIC v. Ogden Corp.* ²⁷ In that case, Citicorp and the FDIC sued Ogden Corporation. Ogden had acquired the banks' interest in a partnership. Under its agreement with the banks, Ogden was directed to pursue the recovery of certain *627 insurance proceeds and pay a portion of the proceeds to the banks. Ogden hired Dickstein, Shapiro, Morin & Oshinsky to handle the insurance claims. The banks and Ogden became embroiled in a dispute over the proceeds recovered by Dickstein, so the banks sued Ogden, and during the course of that lawsuit, they subpoenaed Dickstein. The issue was in *Ogden* was whether the banks were clients of the law firm (Dickstein) even though the law firm had been hired by Ogden.

The court in Ogden noted that courts "customarily determine the existence vel non of an attorney-client relationship by evaluating whether the putative client's belief that such a relationship existed was objectively reasonable under all the circumstances." 28 The Court ultimately concluded that the reasonableness of the banks' belief that Dickstein had become their lawyer was manifest. In part, that ruling was based on evidence that a bank representative had taken copious notes during a meeting with a Dickstein partner, Dickstein had sought the banks' assistance in responding to discovery, and a Dickstein partner sent a letter to one of the banks setting for a detailed legal interpretation of an agreement. ²⁹ But the Court held that Dickstein's engagement letters stating they represented the banks and the firm's appearance in court on behalf of the banks-by itself-was sufficient to establish a co-client relationship:

The entries of appearance and the engagement letters alone constitute powerful proof, and the correspondence evinces a coordinated legal strategy sufficient to lead a reasonable person standing in [the bank's] shoes to infer that Dickstein had become its attorney. ³⁰

Notably, in concluding that a co-client relationship existed between the banks and Dickstein, the court did not rely on the existence of a fiduciary relationship.

[6] The facts in *Ogden* are analogous to those here. Like in *Ogden*, the engagement letters in this case specifically provide that the law firms were retained to represent THMI in the wrongful death cases. The law firms actually made appearances (and advanced legal positions) in the wrongful death cases on THMI's behalf. And those law firms coordinated the legal strategy for THI and THMI. Those facts are sufficient, by themselves, for THMI—like the banks in *Ogden*—to reasonably conclude that it was a client of the law firms. Accordingly, a co-client relationship exists between THI and TMI regardless of the existence or ultimate enforceability of the indemnification agreement.

That leaves for consideration the last argument raised by the THI Receiver: the indemnification provides that Delaware law applies, and a duty to defend does not give rise to a fiduciary duty under Delaware law. ³¹ While the Court's Memorandum *628 Opinion was based, in part, on the existence of a fiduciary relationship arising out of THI's assumption of THMI's defense, a fiduciary relationship is not, for the reasons discussed above, indispensable to the finding of a co-client relationship. That relationship can exist, as just discussed, based on the law firms' engagement letters and appearances in court on behalf of THMI. So, in one sense, the THI Receiver's argument is moot.

Nevertheless, the Court is not convinced that a person assuming the defense of another does not owe the other a fiduciary duty. The THI Receiver cites two cases for the proposition a duty to defend does not give rise to a fiduciary duty under Delaware law. ³² But neither of those cases actually says that. One case stands for the relatively unremarkable proposition that an insurer's duty in handling a claim by a third party is not measurable by the standards of a fiduciary. ³³ The other generally holds that an insurer generally does not owe a fiduciary duty to its plan participants. ³⁴ Neither case actually involved—much less discussed—the duty an insurer owes an insured when it assumes the insured's defense.

And the idea that a party assuming the defense of another does not owe a fiduciary—or analogous—duty to the

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other party seems illogical. Under the THI Receiver's analysis, once it assumed THMI's defense it was free to do whatever it pleased with no recourse. The Court is not convinced Delaware law, if it applies, would allow that.

ORDERED that the motions for reconsideration filed by the THI Receiver and the Fundamental entities are DENIED.

DONE and **ORDERED** in Chambers at Tampa, Florida, on June 17, 2013.

Conclusion

The potential unenforceability of the indemnification agreement is not newly discovered evidence. And even if it was, it would not merit a different result here. Accordingly, it is

All Citations

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Footnotes

- 1 Doc. No. 716. The Court's memorandum opinion is published at *In re Fundamental Long Term Care, Inc.,* 489 B.R. 451 (Bankr.M.D.Fla.2013).
- The Court also specified at the outset of its Memorandum Opinion that it was not making any findings regarding the existence or enforceability of that agreement for any purpose other than determining the existence of a co-client relationship. To be clear, any reference to the existence of the agreement (or any fiduciary duty arising out of it) is for the purposes of determining whether a co-client relationship exists. Any reference to the existence or enforceability of the agreement is not binding on any proceeding pending in this Court to enforce the agreement. Nor should it be binding on this (or any other) Court in an action for malpractice, breach of fiduciary duty, or other related claims.
- 3 Doc. Nos. 732 & 742.
- For a more detailed discussion of the background of this dispute, see the Court's March 2013 Memorandum Opinion. *In re Fundamental Long Term Care, Inc.*, 489 B.R. at 456–60.
- 5 Doc. No. 1.
- 6 Feb. 23, 2012 Hr'g Tr., Doc. No. 31 at 4–5; Doc. No. 23; Mar. 28, 2012 Hr'g Tr., Doc. No. 105 at 6.
- 7 Doc. No. 409. That ruling, which was issued on October 9, 2012, is reported at *In re Fundamental Long Term Care, Inc.*, 2012 WL 4815321 (Bankr.M.D.Fla. Oct. 9, 2012).
- 8 Doc. No. 427.
- 9 Doc. No. 716; In re Fundamental Long Term Care, Inc., 489 B.R. 451 (Bankr.M.D.Fla.2013).
- 10 In re Fundamental Long Term Care, Inc., 489 B.R. at 477.
- **11** *Id.* at 477–78.
- **12** *Id*
- 13 Doc. Nos. 732 & 742.
- 14 Belmont Wine Exchange v. Nascarella (In re Nascarella),492 B.R. 327 (Bankr.M.D.Fla.2013) (quoting In re Waczewski, 2005 WL 1330691, at *1 (Bankr.M.D.Fla.2005)).
- 15 Id.
- 16 Doc. No. 732.
- 17 Id. at ¶ 3.
- 18 Doc. No. 671 at 1.
- 19 In re Fundamental Long Term Care, Inc., 489 B.R. at 455 n. 1.
- 20 Id.
- 21 Id. at 465 (citing Sky Valley Ltd. P'ship v. ATX Sky Valley, Ltd., 150 F.R.D. 648 (N.D.Cal.1993)).
- 22 *Id.* at 466–67.
- 23 Id. at 464–65 (quoting Sky Valley, 150 F.R.D. at 651) (emphasis added).
- As the Court pointed out in its Memorandum Opinion, the record is replete with references to THI's obligations under the indemnification agreement. See In re Fundamental Long Term Care, 489 B.R. at 455 n.1 (citing Doc. Nos. 105, at

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- p. 5; 109 at p. 17; 204 at pp. 9–10; 318 at pp. 27–29; 373 at p. 59; 402 at pp. 127–29; 599 at p. 124). The Trustee has identified additional references. Doc. Nos. 682, 765 & 767.
- See, e.g., FDIC v. Ogden Corp., 202 F.3d 454 (1st Cir.2000) (explaining that courts "may consider multiple factors, including but not limited to matters such as payment arrangements, allocation of decisionmaking roles requests for advice, attendance at meetings, frequency and content of correspondence, and the like"); Luna Gaming-San Diego, LLC v. Dorsey & Whitney, LLP, 2008 WL 4492617, at *5–6 (S.D.Cal. Sep. 30, 2008) (explaining that relevant factors, other than those identified in Sky Valley, include whether the lawyer was paid for its services; the magnitude of the interests involved; whether the party had access to other lawyers; and the relative sophistication of the party involved); Odmark v. Westside Bancorporation, Inc. (In re Odmark), 636 F.Supp. 552, 555–56 (D.Wash.1986) (explaining that the mere subjective belief of the party invoking the co-client exception is not sufficient unless the "belief is minimally reasonable").
- 26 Ogden, 202 F.3d at 461–63.
- 27 *Id.*
- 28 *Id.* at 463.
- 29 Id. at 462-63.
- 30 Id. at 463.
- The Fundamental entities also say the Court's Memorandum Opinion rests on many contested issues of fact. Doc. No. 732 at 3 n.1. It is not clear that either of the Fundamental entities (or any other party) previously raised the need for an evidentiary hearing. And the Fundamental entities only cite to one contested issue of fact—whether the Trustee has "thrown in the towel" on THMI's defense—without much discussion of the issue. In fact, the Court's Memorandum Opinion does not rest on many contested issues of fact. The Court's observation that there was no evidence the Trustee had "thrown in the towel" was part of the Court's discussion regarding the identity between THI's and THMI's interests in the wrongful death cases—a fact that the THI Receiver has conceded numerous times. *In re Fundamental Long Term Care*, 489 B.R. at 466–67.
- 32 Doc. No. 742 at 3 (citing *Crosse v. BCBSD, Inc.*, 836 A.2d 492, 495 (Del.2003); *Corrado Bros. Inc. v. Twin City Fire Ins. Co.*, 562 A.2d 1188, 1192 (Del.1989)).
- 33 Corrado Bros., 562 A.2d at 1192.
- **34** *Crosse,* 836 A.2d at 495–96.

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In re Fundamental Long Term Care, Inc., 509 B.R. 956 (2014)

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509 B.R. 956 United States Bankruptcy Court, M.D. Florida, Tampa Division.

In re: Fundamental Long Term Care, Inc., Debtor. Estate of Juanita Jackson, et al., Plaintiffs,

v.
General Electric Capital
Corporation, et al., Defendants.

Synopsis

Background: Parties who had brought adversary proceeding challenging the linked stock sales transactions by which Chapter 7 debtor acquired company's liabilities prepetition as improper "bust out" scheme sought discovery of information from law firm as to why transaction was structured as it was, as well as disclosure of statements made and e-mail created by firm attorney.

Holdings: The Bankruptcy Court, Michael G. Williamson, J., held that:

- [1] plaintiffs failed to make sufficient showing that debtor was firm's client, as required for application of co-client exception to attorney-client privilege;
- [2] plaintiffs did not sufficiently demonstrate any fraud or criminal misconduct at discovery stage of proceeding, as required to permit bankruptcy court to order production of attorney communications as to why asset sales were structured as they were under crime-fraud exception to attorney-client privilege;
- [3] attorney-client privilege did not protect any statements made by representative of company that law firm was representing in presence of another individual who was not present at law firm's offices as client of firm; but
- [4] court had to review e-mail in camera to determine whether it was privileged.

So ordered.

West Headnotes (7)

[1] Privileged Communications and Confidentiality

Common interest doctrine; joint clients or joint defense

Two parties are not necessarily co-clients, for purposes of application of co-client exception to attorney-client privilege, simply because they share the same lawyer; rather, party is entitled to invoke co-client exception only if it would have been reasonable for party, taking into account the relevant circumstances, to infer that it was, in fact, a client of lawyer.

Cases that cite this headnote

[2] Bankruptcy

Privilege

Corporate Chapter 7 debtor that, in connection with linked stock transactions by which company's assets were allegedly separated from its liabilities, had appeared through its elderly principal at offices of law firm which represented the other buyer to sign purchase documents was not itself a client of this firm, for purposes of application of co-client exception to attorney-client privilege, simply because firm was involved in debtor's incorporation shortly in advance of stock sales transactions, or because firm had reviewed purchase documents before they were signed by debtor's principal; these facts, standing alone, would not have made it reasonable for debtor to infer that it was law firm's client, where there was nothing in firm's engagement letter with other buyer to indicate that it was also representing debtor.

Cases that cite this headnote

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[3] Privileged Communications and Confidentiality

Example 2 Criminal or other wrongful act or transaction; crime-fraud exception

Attorney-client privilege does not protect communications made in furtherance of a crime or fraud.

Cases that cite this headnote

[4] Privileged Communications and Confidentiality

Criminal or other wrongful act or transaction; crime-fraud exception

To avail itself of crime-fraud exception to attorney-client privilege, party must make a prima facie showing: (1) that client was engaged in, or planning, criminal or fraudulent conduct when it sought legal advice from attorney, and (2) that attorney's assistance was obtained in furtherance of the criminal or fraudulent conduct.

Cases that cite this headnote

[5] Bankruptcy

Privilege

While facts which surrounded linked stock sales transactions by which all of company's valuable assets were allegedly diverted to one buyer and the other was allegedly left behind as liability-ridden shell to hinder, delay, or defraud company's creditors pursuant to alleged "bust out" scheme were sufficient to raise court's suspicions, plaintiffs challenging these linked stock sales transactions as an improper "bust out" did not sufficiently demonstrate any fraud or criminal misconduct at discovery stage of proceeding, as required to permit bankruptcy court to order production of attorney communications as to why asset sales were structured as they were under crime-fraud exception to attorney-client privilege.

Cases that cite this headnote

[6] Bankruptcy

Privilege

Attorney-client privilege did not protect any statements made by representative of company that law firm was representing in presence of another individual who was not present at law firm's offices as client of firm, but as principal of the other buyer involved in linked stock sales transactions by which seller's assets were allegedly separated from its liabilities; presence of this other individual, who was admittedly not a firm client, when communications were made, destroyed confidential nature of communications.

Cases that cite this headnote

[7] Bankruptcy

Privilege

While conduct of attorney at law firm, in response to communication from senior partner that one of attorney's colleagues may have been involved in questionable deals, in sending e-mail to his private account that simply memorialized attorney's thoughts about another prior questionable deal involving this same colleague, could not convert an otherwise non-privileged communication into privileged one, bankruptcy court could not determine, without reviewing e-mail in camera, whether e-mail was in response to request that attorney investigate colleague, and whether it was protected as attorney's work product or on some other ground.

Cases that cite this headnote

Attorneys and Law Firms

*957 Steven M. Berman, Esq., Seth P. Traub, Esq., Shumaker, Loop & Kendrick, LLP, Counsel for the Chapter 7 Trustee.

James Sottile, Esq., Zuckerman Spaeder, LLP, Counsel for Fundamental Long Term Care Holdings, LLC.

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*958 Chapter 7

MEMORANDUM OPINION ON PRIVILEGE OBJECTIONS TO TESTIMONY AND PRODUCTION OF DOCUMENTS BY TROUTMAN SANDERS

Michael G. Williamson, United States Bankruptcy Judge

The Plaintiffs have deposed a partner (formerly a senior associate) in a law firm about two stock sale transactions he worked on. The partner refused to testify about or disclose (i) the reasons the transactions were structured the way they were, (ii) the reason why the transactions were required to be closed simultaneously, (iii) a junior associate's observations of (and concerns about) what took place at the closing of one of the stock sales, and (iv) an e-mail the partner (then a senior associate) sent to his own personal e-mail account memorializing his concerns. The Court is asked to determine whether the communications or the e-mail are protected from disclosure under the attorney-client privilege or work product doctrine.

The Court concludes that the reasons why the sale transactions were structured the way they were and closed simultaneously are, in fact, privileged. And the Plaintiffs cannot invoke either the co-client or crime fraud exception to discover them. As for the junior associate's observations and concerns (which he expressed to the partner), those cannot be privileged because they involved objective facts or communications that took place in the presence of a third party. So the Plaintiffs are entitled to discover the junior associate's communications to the partner conveying his observations (and concerns). But, at this point, the Court cannot determine whether the e-mail is protected work product without first reviewing it in camera.

For those reasons, the Court will sustain the privilege objections, in part, and overrule them, in part.

Background

The claims in this adversary proceeding principally arise out of two linked stock sale transactions that took place in March 2006. ¹ In one of the sales, Fundamental Long Term Care Holdings, LLC ("FLTCH") acquired all of the stock in THI of Baltimore, LLC ("THI–Baltimore") and THI of Nevada ("THI–Nevada"). In the other sale, Trans Healthcare, Inc. ("THI") sold all of its stock in Trans Health Management, Inc. ("THMI") to the Debtor. According to the story laid out by the Plaintiffs in their complaint, the linked transactions were part of an elaborate "bust-out" scheme intended to divert all of THMI's assets to FLTCH (and others) and leave behind a liability-ridden shell to defraud, hinder, and delay THMI's creditors. ²

There is a long list of characters in what this Court previously said has all of the makings of a legal thriller. For starters, there is Leonard Grunstein, a former partner at the law firm of Troutman Sanders, LLP, who owns a one-half interest in FLTCH (the entity that allegedly acquired all of THMI's assets). There is Barry Saacks, an 80-year-old man currently living in a nursing home, who supposedly *959 formed the Debtor back in 2005 so that he could acquire the stock in THMI. But for purposes of this chapter in the story, the main character is Brett Baker.

Brett Baker—now a partner at Troutman Sanders—was a senior associate at the firm when it closed the two stock sale transactions that are the subject of this adversary proceeding. ⁵ Troutman Sanders designated Baker as its Rule 30(b)(6) representative with the most knowledge about the linked transactions. The Plaintiffs recently deposed Baker, and during his deposition, Baker testified at some length about a variety of topics related to the linked transactions. ⁶

According to Baker, he began working on the linked transactions sometime in October or November 2005. ⁷ It appears from his deposition transcript that Baker knew he would be working on a transaction involving the sale of stock in THI–Baltimore, THI–Nevada, and THMI. But, at least at the outset, he was not aware who the buyer was going to be. ⁸ Apparently, the transaction (as originally conceived) was going to involve one entity acquiring stock

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in THI–Baltimore, THI–Nevada, and THMI. ⁹ Later, it was decided that the acquisition of the three entities would take place as part of two transactions (with two buyers).

Once it was decided that the stock sales would take place as part of two transactions, Troutman Sanders incorporated FLTCH (the entity acquiring THI–Baltimore and THI–Nevada) and the Debtor (the entity acquiring THMI). Troutman Sanders apparently incorporated FLTCH at the request of Murray Forman (who, along with Grunstein, owns FLTCH). ¹⁰ And FLTCH, once it was formed and became a Troutman Sanders client, instructed the firm to incorporate the Debtor. Despite incorporating the Debtor, however, Troutman Sanders is adamant that the Debtor was never a firm client.

Notwithstanding that, Troutman Sanders concedes it did take some action on the Debtor's behalf based on instructions from FLTCH. For instance, FLTCH apparently asked Troutman Sanders to review and make comments to the documents for the THMI stock sale even though it was not a party to that transaction. ¹¹ Baker says FLTCH also asked Troutman Sanders to obtain Saacks' signature (on behalf of the Debtor) when the THMI stock sale closed, ¹² and it is what happened when Troutman Sanders obtained Saacks' signature that has really led to this discovery dispute.

As it turns out, Baker delegated the responsibility for obtaining Saacks' signature to a junior associate named Shawn *960 Fischman (a second or third-year associate at the time). ¹³ On the day Saacks came into Troutman Sanders' office to sign the sale documents, Fischman met Saacks in a conference room. ¹⁴ Also in the conference room at the time was Grunstein. ¹⁵ What Fischman observed at the signing apparently caused him some concern, so he shared his observations and concerns with Baker. ¹⁶

According to Baker, Fischman expressed concerned about Saacks' appearance. ¹⁷ Fischman described Saacks, who Baker understood as living in the basement of someone's home, as being disheveled and having hygiene issues. ¹⁸ More significantly, Fischman was concerned about an interaction he observed between Grunstein and Saacks. ¹⁹

Baker, however, would not divulge what Fischman told him about the interaction between Saacks and Grunstein. ²⁰

All we know, at this point, is that Baker, based on his conversation with Fischman, became concerned about Saacks signing the sale documents on THMI's behalf. ²¹ So Baker shared his concerns with two partners at Troutman Sanders, neither of whom had any economic affiliation or stake in the stock sale transactions. ²² In addition to his conversation with the two Troutman Sanders partners, Baker apparently memorialized his concerns—albeit three years later—in an e-mail he sent from his work account to his personal account. ²³

The Plaintiffs now seek to discover the contents of Fischman's conversation with Baker about the closing, as well as the contents of the e-mail Baker sent to his own personal account. ²⁴ The Plaintiffs also seek to discover certain communications between Troutman Sanders and Forman and other internal Troutman Sanders communications. ²⁵ Troutman Sanders has *961 objected to producing a copy of Baker's e-mail based on the attorney-client privilege and work product doctrine, while FLTCH initially objected to all of the other communications being disclosed also based on privilege. ²⁶

To its credit, though, FLTCH has since revisited some of its privilege objections. In doing so, FLTCH has agreed to withdraw its objections to questions about (i) whether the Debtor had any oral or written agreements with Forman, Grunstein, or FLTCH; (ii) whether Troutman Sanders had any discussions about its ongoing responsibilities for maintaining the Debtor's corporate status; (iii) who closed the THMI stock sale; (iv) who determined the \$100,000 purchase price for the THMI stock sale; and (v) Fischman's observations at the closing (including any interaction between Grunstein and Forman) and his communications to Baker about them. FLTCH has also agreed to withdraw its privilege objections with respect to the following topics provided the Trustee can establish Baker's knowledge comes from some source other than communications between the firm and FLTCH: (i) communications Forman may have had with a group referred to as the GTCR Entities; (ii) whether Forman and Grunstein were going to own the Debtor at some

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point in time; and (iii) the names of entities identified on a corporate structure diagram. But FLTCH contends that testimony about the reason the transactions were structured the way they were and the contents of a "side letter agreement"—and the reasons for that agreement—are absolutely privileged.

Conclusions of Law

The communications relating to the reasons the transactions were structured the way they were and the contents of (and reasons for) the "side letter agreement" appear to be privileged on their face. After all, those communications (from the Court's review of Baker's deposition transcript) are unquestionably between a client (FLTCH) and an attorney (Troutman Sanders). And those communications undoubtedly involve legal advice. The Trustee's argument that those communications cannot constitute legal advice because, to some extent, they came about in connection with services being provided on the Debtor's behalf is simply unavailing. ²⁷ There really is no question the attorney-client privilege applies to those communications. The only issue is whether the Trustee is entitled to those communications under the co-client or crime-fraud exceptions.

[1] This Court addressed the co-client exception at great length in an earlier ruling in this case. ²⁸ In that ruling, the Court recognized that two parties are not necessarily co-clients—for purposes of invoking the co-client exception—simply because they share the same lawyer. ²⁹ Instead, a party is entitled to invoke the co-client exception only where it would have been reasonable—taking into account the relevant circumstances—for the person to infer it was, in fact, a client of the lawyer. So the proper inquiry, under the Court's earlier ruling, is whether it would have been reasonable for the Debtor (through *962 Saacks) to have inferred it was a Troutman Sanders client.

[2] The Court concludes the Trustee has failed to make that showing here. In reality, there are only two facts that suggest any attorney-client relationship between Troutman Sanders and the Debtor: First, Troutman Sanders incorporated the Debtor. Second, Troutman Sanders reviewed the THMI sale documents and provided comments on them. Neither of those facts alleged by the Trustee—by themselves—demonstrates that it would have

been reasonable for the Debtor to have inferred it was a Troutman Sanders client.

The facts of this dispute are distinguishable from those giving rise to the Court's earlier co-client ruling. There, the Court concluded it was reasonable for THMI to have inferred it was a client of law firms retained by its former parent to defend itself and THMI in six wrongful death (or negligence) cases because (i) the parties believed (or acted as if) THMI's former parent was obligated to indemnify and defend THMI in the six wrongful death (or negligence) cases; (ii) the engagement letters specifically provided that the law firms were retained to represent THMI; (iii) the law firms actually made appearances in the cases—and coordinated legal strategy—on THMI's behalf; (iv) the duty to defend (or actual defense of) THMI would have given rise to a fiduciary duty; and (v) the indemnity agreement the parties were acting under gave THMI a contractual right to access the litigation files. ³⁰

Here, none of those (or similar) facts are present. FLTCH did not have—nor was it acting under—some contractual obligation to provide counsel for the Debtor. There is no evidence that Troutman Sanders' engagement letter provides that the firm is representing the Debtor. At best, Troutman Sanders assumed a fiduciary duty to the Debtor by reviewing the THMI sale documents. But the Court is not convinced that the Debtor was a client of the firm simply because Troutman Sanders reviewed sale documents on THMI's behalf.

In fact, this Court previously ruled—on basically the same facts-that the Debtor was not a Troutman Sanders client. 31 The Trustee previously sought to compel documents from Troutman Sanders relating to the linked transactions. 32 In order to defeat Troutman Sanders' assertion that those documents were protected by its attorney-client privilege with FLTCH, Forman, and Grunstein, the Trustee contended that the Debtor was a co-client. 33 This Court, however, rejected the argument that the co-client exception applied back then. And it rejects it again now. That is not to say, however, that the Trustee would not be able to present additional facts entitling her to invoke the co-client exception in the future, only that those facts are not in the record as of now, and as a consequence, the Trustee cannot invoke the co-client exception to obtain communications between FLTCH and Troutman Sanders.

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exception to discover those communications. It is well known that the attorney-client privilege does not protect communications made in furtherance of a *963 crime or fraud. 34 In order to avail themselves of the crime-fraud exception, the Plaintiffs must demonstrate (i) a prima facie showing that FLTCH was engaged in (or planning) criminal or fraudulent conduct when it sought legal advice from Troutman Sanders; and (ii) that Troutman Sanders' assistance was obtained in furtherance of the criminal or fraudulent conduct. 35 The Court concludes that the Trustee has failed to demonstrate a prima facie showing of criminal or fraudulent conduct by FLTCH.

To be sure, the THMI stock sale, on its face, raises a number of questions. The Court understands the theory —as it has been presented at various points in the main bankruptcy case and other proceedings—is that Saacks incorporated the Debtor to acquire THMI's computer equipment, which he intended to lease to Fundamental Administrative Services (a newly created entity that provided administrative services to the nursing homes acquired by FLTCH). But why would Saacks—an elderly graphic designer—acquire the stock in a company that was subject to millions of dollars in liability simply to obtain some computer equipment? Why not simply enter into an asset purchase agreement? And how is it, assuming the allegations of the Plaintiffs' complaint are true, that Saacks never paid the \$100,000 purchase price, never received the computer equipment, and apparently has never received any lease payments from FAS? Having said all of that, all of those questions-other than the one about why Saacks would enter into a stock sale agreement rather than an asset sale agreement—are based on mere allegations at this point.

In the end, there is not sufficient record evidence for the Plaintiffs to meet their prima facie showing. Given that, the Court is uncomfortable invoking the crimefraud exception. For starters, the criminal or fraudulent conduct that would give rise to the exception happens to be one of the ultimate issues this Court must decide at trial. Moreover, invoking the crime-fraud exception would have wide-ranging ramifications on discovery in this case. For all of those reasons, the Court concludes the Trustee is not entitled to invoke the crime-fraud exception.

That leaves for consideration the contents of Fischman's [4] [5] Nor can the Trustee invoke the crime-fraud conversation with Baker about the closing, as well as the contents of the e-mail Baker sent to his own personal account. The privilege analysis with respect to the contents of Fischman's communications with Baker appears relatively straightforward. 36 Those communications center on an interaction between Grunstein and Saacks. Ordinarily, resolution of whether Fischman's communications to Baker about Grunstein's interactions with Saacks are privileged would rise or fall on the reason Saacks was in the room-i.e., whether Saacks was in the room as a client or third party.

> [6] But, in this case, the interaction between Grunstein and Saacks cannot be privileged regardless of what Saacks' (legal *964 not mental) capacity was. As far as the Court can tell, Saacks was in the room to sign the THMI sale documents. That means he was there in his capacity as an officer or shareholder of the Debtor. Troutman Sanders has adamantly insisted neither the Debtor nor Saacks was its client. And the Court has agreed, at least at this stage of the proceeding, that there is insufficient evidence to demonstrate that the Debtor was a firm client. Because Saacks (as the Debtor's representative) was not present in the room as a Troutman Sanders client, any statements made by Grunstein to Saacks (or, for that matter, others) cannot be privileged since the presence of a third party destroys the confidential nature of the communication. 37

FLTCH cannot overcome that fatal defect by claiming that it is unclear whether Saacks was a Troutman Sanders client: assuming Troutman Sanders did represent Saacks at some point, nobody has argued that any interactions or communications between Grunstein and Saacks were in their capacity as attorney and client. 38 That alone defeats any privilege claim. Nor can FLTCH shield the conversation between Baker and Fischman from discovery by claiming, as it appears to, that "there was confidential client information divulged by Mr. Grunstein to Troutman Sanders at that meeting in the context of the deal." 39

That argument simply begs the question. 40 In other words, FLTCH's argument hinges on the assumption that the information conveyed by Grunstein was "confidential"; yet, that is ultimately the conclusion that needs to be proven. And FLTCH cannot prove

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the communication was confidential since it was communicated in the presence of a third party. ⁴¹ So the communications between Fischman and Baker about Fischman's observations at the closing cannot be privileged.

[7] The e-mail that Baker sent to his own personal account presents a more challenging question. After Baker disclosed the existence of the e-mail for the first time during his deposition, the firm amended its privilege log to claim the e-mail was privileged because it disclosed the legal advice he provided to FLTCH. Now Troutman Sanders is claiming it is entitled to assert its own attorney-client privilege and work product doctrine to shield the e-mail from disclosure.

Troutman Sanders principally relies on the Ninth Circuit Court of Appeals' decision in *United States v. Rowe* in support of its argument. ⁴² In *Rowe*, Charles Rowe (a senior partner in a law firm) asked two of his young associates to investigate the conduct of another attorney (W. Lee McElravy) who was suspected of mishandling client funds. A grand jury investigating McElravy later subpoenaed the associates *965 who investigated him. The issue in *Rowe* was whether the results of the investigation the senior partner tasked the junior associates with was protected under the attorney-client privilege or work product doctrine. ⁴³

The Ninth Circuit concluded the investigation was privileged. 44 The court reasoned that the associates were effectively serving as in-house counsel to the firm when Rowe tasked them with the investigation. 45 And according to the court, a factual investigation by an attorney constitutes the rendition of legal services under *United States v. Upjohn.* 46 Because a factual investigation constitutes the rendition of legal services, the court concluded the investigation was just as much protected under the attorney-client privilege as it would have been had a company—like the one in *Upjohn* —been the one that asked its attorneys to conduct the investigation.

On its face, the facts of this case appear to be distinguishable from *Rowe* in one crucial respect: this case does not appear to involve any investigation by a firm associate. Unlike the law firm in *Rowe*, Troutman Sanders does not contend it asked Baker to investigate Grunstein. Instead, Troutman Sanders says it prepared the e-mail

after receiving communication from the firm's general counsel:

Mr. Baker prepared the e-mail after Troutman Sanders' general counsel advised his client, the partners of the firm, regarding a newly unsealed *Qui Tam* proceeding involving Mr. Grunstein, and others, and regarding Mr. Grunstein going on leave of absence from Troutman Sanders to address that matter. ⁴⁷

Simply memorializing thoughts about a prior questionable deal involving one of your colleagues in response to a communication from a senior partner that the colleague has potentially been involved in other questionable deals does not convert otherwise non-privileged communications into privileged ones. And the Court cannot infer that Baker's e-mail was in response to a firm request for him to investigate Grunstein considering he sent the e-mail (what would presumably be the results of his "investigation") to his own personal e-mail account. Because it does not appear that Baker prepared the e-mail at the request of the firm as part of an investigation, then the e-mail likely would not be work product.

The Court, however, is reluctant to compel discovery on that basis alone for two reasons. First, while it appears *Rowe* —or at least its analysis—does not dictate the result in this case, that is not altogether clear without seeing the e-mail. Second, Troutman Sanders raises the issue that the e-mail may contain the advice the firm gave FLTCH, which, again, this Court cannot know without seeing the e-mail. For those reasons, the Court believes it is appropriate for it to review the e-mail in camera to determine whether it should be produced at all and, assuming it should be produced, whether portions of it need to be redacted. If, after reviewing the e-mail in camera, the Court determines any portion of the e-mail is not privileged, the Court will deliver the e-mail to the parties with such redactions as are appropriate for use in the rescheduled deposition of Baker.

*966 Conclusion

The central focus of the Plaintiffs' discovery request is the facts and circumstances surrounding the closing of the

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THMI stock sale. The Plaintiffs are entitled to discover the communications between Fischman and Baker regarding what Fischman observed at the closing (i.e., Saacks' appearance and Grunstein's interaction with him) because Saacks' presence at the closing—by itself—defeats the privilege. At this point, however, the Court is unable to determine whether the e-mail is (or portions of it are) discoverable until it reviews it in camera. And the Court concludes the Trustee is not entitled to testimony about

the reason the transactions were structured the way they were or the contents of a "side letter agreement." The Court will enter a separate order consistent with this Memorandum Opinion.

All Citations

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Footnotes

- Adv. Doc. No. 109 at ¶¶ 261–394. References to filings in this adversary proceeding will be to "Adv. Doc. No. __."

 References to filings in the main bankruptcy case will be to "Doc. No. __."
- 2 Id. As is well known in this case, six of the plaintiffs in this proceeding are probate estates, four of which have obtained more than \$2 billion in judgment against THMI (although some of those judgments are on appeal and at least one has been overturned).
- 3 *Id.* at ¶¶ 69–73.
- 4 *Id.* at ¶¶ 309–14.
- The Court is aware there may be a dispute about whether Troutman Sanders "closed" the THMI stock sale. In fact, FLTCH objected to Baker answering questions about who "closed" the sale on the basis of privilege. But there is no question that Troutman Sanders obtained the signature from the Debtor for the closing.
- A copy of Baker's deposition transcript was attached to the Trustee's motion to overrule the privilege objections by Troutman Sanders and FLTCH. Adv. Doc. No. 340–1 & 340–2 (the "Baker Transcript")
- 7 Baker Transcript at p. 90, 1. 14—p. 92, 1. 7.
- 8 *Id.* at p. 95, 1. 21—p. 96, 1. 4.
- 9 *Id.* at p. 105, 1. 21—p. 106, 1. 18.
- 10 *Id.* at p. 130, 11. 4–14.
- 11 *Id.* at p. 133, 1. 20—p. 134, 1. 14.
- 12 *Id.* at p. 128 11. 15–21; p. 133, 11. 20—p. 134, 1. 3; p. 139, 11. 5–17.
- 13 *Id.* at p. 139, 11. 5–17; p. 185, 11. 11–18.
- 14 *Id.* at p. 189, 1. 1—p. 194, 1. 3; p. 199, 1. 15—p. 201, 1.6.
- 15 *Id*
- 16 *Id.* at p. 194, 1. 4—p. 201, 1. 2.
- 17 *Id.* at p. 197, 11. 17–23.
- 18 *Id.*
- 19 *Id.*
- 20 *Id.* at p. 197, 1. 24—p. 198, 1. 2.
- 21 *Id.* at p. 180, 1. 2—p. 182, 1. 12; p. 186, 1. 8—p. 201, 1.2.
- 22 *Id.* at p. 180, 1. 2—p. 182, 1. 12.
- 23 *Id.* at p. 218, 1. 20—p. 219, 1. 15.
- 24 Adv. Doc. No. 340 at ¶¶ 11 & 12.
- 25 Id. at ¶ 9. The specific communications the Plaintiffs seek to recover are identified by page and line number in their motion. Those communications relate to, among other things: (i) the reason the stock sales were structured the way they were; (ii) who closed the THMI stock sale; (iii) the reason for Troutman Sanders reviewing the THMI documents, (iv) whether FLTCH communicated to the entities selling THI-Baltimore and THI of Nevada that it wanted that sale to close simultaneously with the THMI stock sale; (v) why an agreement to conduct simultaneous closings was included in a letter agreement rather than the stock sale agreements; (v) whether Troutman Sanders ever represented Rubin Schron; (vi) the names of entities contained on a corporate structure diagram; (vii) the contents of a "side letter agreement" and the reasons why the transactions were required to close simultaneously; (viii) discussions about Troutman Sanders' ongoing obligations for the Debtor's corporate status; (ix) whether the Debtor had any oral or written contracts with Forman,

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Grunstein, or FLTCH; (x) Baker's understanding of who would own the company purchasing THMI; (xi) who determined the \$100,000 purchase price for THMI; and (xii) why Baker told another Troutman Sanders attorney to name the company acquiring THMI's stock Fundamental Long–Term Care Management, Inc. Adv. Doc. No. 382 at 2–3.

- 26 Adv. Doc. No. 377.
- The Plaintiffs devote one sentence to the argument the attorney-client privilege does not apply. According to the Plaintiffs, Troutman Sanders could not have been doing legal work for FLTCH when it reviewed and commented on the THMI stock sale agreements. Adv. Doc. No. 340 at ¶ 14.
- 28 In re Fundamental Long Term Care, Inc., 489 B.R. 451, 463–70 (Bankr.M.D.Fla.2013).
- 29 *Id.* at 464–65.
- 30 Id. at 463-70; In re Fundamental Long Term Care, Inc., 493 B.R. 620, 626-28 (Bankr.M.D.Fla.2013).
- 31 Doc. No. 752.
- 32 Doc. No. 631.
- 33 *Id.* at ¶¶ 7–9.
- 34 In re Grand Jury Investigation, 842 F.2d 1223, 1226 (11th Cir.1987).
- 35 Id.
- At the May 5, 2014 hearing on these privilege issues, FLTCH said it does not have any privilege to assert with respect to the communications between Fischman and Baker about Fischman's observations and concerns. So any privilege would belong to Troutman Sanders. But Troutman did not—nor, for that matter, did anyone else—argue at the May 5 hearing that those communications were privileged. So it appears any privilege objection has been withdrawn. Nonetheless, the Court addresses the issue in an abundance of caution.
- 37 Hanson v. U.S. Agency for Int'l Dev., 372 F.3d 286, 294 (4th Cir.2004); Jackson v. Deen, 2013 WL 2027398, at *8 (S.D.Ga. Apr. 3, 2013).
- During Baker's deposition, FLTCH raised the possibility that Saacks was a Troutman Sanders client. Baker Transcript at p. 206, 1.1—p. 207, 1. 12. But at the May 5 hearing on these privilege issues, neither FLTCH nor Troutman Sanders raised this issue. The Court assumes their failure to raise that issue is basically a concession the attorney-client privilege does not apply to those communications. Again, the Court will briefly address this specific argument in an abundance of caution.
- 39 Baker Transcript at p. 202, 11. 15–21.
- 40 In re Stanton, 503 B.R. 760, 764 & n. 23 (Bankr.M.D.Fla.2014).
- 41 Hanson, 372 F.3d at 294; Deen, 2013 WL 2027398, at *8 (S.D.Ga. Apr. 3, 2013).
- 42 96 F.3d 1294 (9th Cir.1996).
- 43 *Id.* at 1295–96.
- 44 *Id.* at 1296.
- 45 *Id.* at 1296–97.
- 46 Id. (citing Upjohn Co. v. United States, 449 U.S. 383, 390-91, 101 S.Ct. 677, 66 L.Ed.2d 584 (1981)).
- 47 Adv. Doc. No. 377 at ¶ 13.

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In re Fundamental Long Term Care, Inc., 515 B.R. 857 (2014)

515 B.R. 857 United States Bankruptcy Court, M.D. Florida, Tampa Division.

In re: Fundamental Long Term Care, Inc., Debtor. Estate of Juanita Jackson, et al., Plaintiffs,

v.

General Electric Capital Corporation, et al., Defendants.

Case No. 8:11-bk-22258-MGW

|
Adv. No. 8:13-ap-00893-MGW (consolidated)

|
Signed 09/20/2014

Synopsis

Background: Trustee of Chapter 7 estate of corporation that was one of defendants represented by law firm in pending wrongful death actions sought determination as to her right to introduce at trial of adversary proceeding certain documents that she had previously acquired under co-client exception to attorney-client privilege.

Holdings: The Bankruptcy Court, Michael G. Williamson, J., held that:

- [1] by failing to object, within time established by bankruptcy court, to introduction at trial of allegedly confidential documents identified by trustee on document list, party waived any objection to introduction of these documents:
- [2] even assuming that trustee could use confidential documents that she acquired under co-client exception to attorney-client privilege only in subsequent adverse litigation with other co-clients, any such requirement was satisfied; and
- [3] while other parties generally would not be excluded from trial when trustee introduced co-client documents, appropriate steps would be taken to protect plaintiffs in wrongful death action, who were also parties to adversary proceeding, from gaining access to confidential information regarding law firm's strategy for defending wrongful death actions.

So ordered.

West Headnotes (3)

[1] Bankruptcy

Privilege

By failing to object, within time established by bankruptcy court, to introduction at trial of allegedly confidential documents identified by Chapter 7 trustee on document list, party to adversary proceeding waived any objection to introduction of these documents.

Cases that cite this headnote

[2] Bankruptcy

Privilege

Even assuming that Chapter 7 trustee, as successor in interest to corporate debtor that was one of the companies represented by law firm in pending state court wrongful death actions, could use confidential documents that she acquired under co-client exception to attorney-client privilege only in subsequent adverse litigation with other co-clients, presence as party to adversary proceeding of company which was one of the two other coclients, which was also the third co-client's agent and its litigation liaison in virtually, if not all, of communications in question, and which had right and responsibility to defend third co-client in underlying state court litigation for which the joint legal representation was obtained, was sufficient to satisfy any such requirement and to permit trustee to use documents at trial.

Cases that cite this headnote

[3] Bankruptcy

Privilege

Bankruptcy

Use and effect in evidence

While, as general rule, it was unnecessary to exclude any parties from trial when Chapter 7 trustee introduced certain documents that she acquired, under co-client exception to attorney-client privilege, as successor in interest to one of the corporations represented by law firm in pending state court wrongful death actions, given that many of these documents were not privileged in first place, that others did not reflect any attorney's mental impressions, opinions, or legal theories, and that trustee had right to waive privilege with respect to corporate debtor's own communications with law firm, appropriate steps would be taken to protect plaintiffs in wrongful death action, who were also parties to adversary proceeding, from gaining access to confidential information regarding law firm's strategy for defending wrongful death actions.

Cases that cite this headnote

Attorneys and Law Firms

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Matthew E. Nirider, Esq., Kirkland & Ellis LLP, Jeffrey W. Warren, Esq., Bush Ross, P.A., Counsel for GTCR Associates, VI; GTCR Fund VI, LP; GTCR Golder Rauner, LLC; GTCR Partners VI, LP; GTCR VI Executive Fund, LP; Edgar D. Jannotta, Jr.; THI Holdings, LLC.

Chapter 7

ORDER AND MEMORANDUM OPINION ON USE OF CONFIDENTIAL EXHIBITS AT TRIAL

Michael G. Williamson, United States Bankruptcy Judge

The Chapter 7 Trustee obtained documents relating to the defense of the Debtor's subsidiary, Trans Health Management, Inc. ("THMI"), in certain negligence actions under the co-client exception to the attorney-client privilege during discovery in this proceeding. Now the Trustee wants to use some of those co-client documents as exhibits at trial. The Receiver for THMI's former corporate parent, Trans Healthcare, Inc. ("THI"), which is not a party to this proceeding, objects. So too does Fundamental Administrative Services, LLC ("FAS"). THI and FAS, who are the other co-clients, say the Trustee does not have the right to unilaterally waive the attorney-client privilege. The Court must decide whether the co-client documents can be used at trial and, if so, under what conditions.

The Court concludes the documents can be used at trial because one co-client may not invoke the attorney-client privilege against the other co-client in subsequent adverse litigation between the parties. Although THI is technically not a party to this proceeding, FAS is, and FAS is the THI Receiver's agent and is the real party in interest with respect to the co-client exception. And there is no reason to exclude any of the parties from the courtroom when the co-client documents are introduced during trial because most of the documents are not privileged or protected work product in the first place, and to the extent they are, the privilege can be waived or the privileged material can be redacted.

Background

Starting in 2004, a series of negligence or wrongful death cases were filed against THI and THMI in state court by six probate estates (the "Probate Estates") that are creditors in this bankruptcy case. For reasons that are still not entirely clear, THI retained lawyers to defend THMI in *859 that litigation. At times, THI has contended it did so under an indemnification agreement. Other times,

In re Fundamental Long Term Care, Inc., 515 B.R. 857 (2014)

it contended it did so under a course of dealing. Whatever the reason, THI and THMI were represented by the same lawyers in the negligence actions. ¹

Not long after this bankruptcy case was filed, the Trustee (who the Court previously ruled had the right to control THMI)² requested copies of the litigation files for the negligence cases from the firms that defended THMI. There is no need to recount the whole history of that discovery dispute here. Suffice it to say, THI's state-court receiver, at least some of the law firms that defended THMI, and in-house counsel at FAS all objected to production based on the attorney-client privilege and work-product doctrine. This Court ruled that the Trustee was entitled to litigation files under the co-client exception to the attorney-client privilege, ³ and eventually, the Trustee received them.

Naturally, she proposes to use some of the documents she received at the trial in this proceeding. The deadline for exchanging exhibits lists was August 29, 2014. As the Court understands it, the Trustee served two exhibit lists by that date. One exhibit list identified all of the nonconfidential documents the Trustee intended on using at trial. The other exhibit list identified just the confidential documents. Objections to proposed exhibits were due September 12, 2014, and under the parties' agreed pre-trial order, any exhibits that were not objected to would be admitted at the outset of the September 22, 2014 trial.

From the Court's review of the record, it does not appear that any of the parties objected to the Trustee's confidential trial exhibits. Of course, none of the Defendants other than FAS had copies of any of the documents identified on the confidential exhibit list. So they could not have raised foundation, hearsay, and other similar objections. ⁴ But FAS had at least some (if not all) of the documents, and the Trustee's confidential exhibit list identified the proposed exhibits by Bates-label number. Yet, FAS did not object to any of the confidential documents by the September 12 deadline. So the Trustee asked the Court to consider the confidential or privileged nature of the exhibits on her confidential exhibit list and permit her to use those documents at trial. ⁵

The reason for the Trustee's motion really has to do with this Court's previous co-client ruling. ⁶ In that ruling, the Court prohibited the Trustee from disclosing the *860

litigation files she received under the co-client exception to any third party who would destroy the privilege. The Court's principal concern was one raised by the THI Receiver, FAS, and others: namely, not allowing the Trustee to turn the litigation files over to the Probate Estates—her co-Plaintiffs in this proceeding but opposing party in the negligence cases. By previously prohibiting the Trustee from disclosing the litigation files without Court approval, the Court prevented the Probate Estates from gaining access to the defense strategy to the negligence cases they filed—some of which are still pending—as the THI Receiver, FAS, and others feared would happen once the Trustee had access to the files. 8

Both FAS and the THI Receiver now object to the Trustee's use of any co-client documents at trial. Their objections can be summed up in two points: First, the fact that the Trustee obtained documents under the co-client exception during discovery does not mean she can use them at trial. Second, assuming co-client documents can be used at trial, they can only be used where both co-clients are adverse parties in subsequent litigation and the subject of the subsequent litigation is the same as the subject of the joint representation. The objections are without merit.

Conclusions of Law 9

FAS's failure to timely object to the co-client documents constitutes a waiver of its objections

[1] As a threshold matter, the Court concludes that FAS waived any objection to the use of the co-client documents. The Trustee timely disclosed her intent to use the co-client documents by identifying them on her witness list. FAS was required to object to the use of those exhibits at trial by September 12, 2014. For some reason, it failed to do so. FAS says that its failure to object does not constitute a waiver because the Trustee, in FAS's view, only listed the documents "aspirationally." Of course, all exhibit lists are aspirational in the sense that the party serving the exhibit list desires to use the proposed exhibits at trial. In fact, it is the "aspirational" nature of the list-i.e., that the Trustee wants to use the proposed exhibits—that required FAS to object. Because FAS offers no legitimate reason for not objecting to the proposed exhibits, any objections by FAS are waived.

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Nevertheless, the Court must address the co-client issue on the merits because it has been raised by the THI Receiver.

The Trustee can use the co-client documents at trial

[2] The Court is not convinced there is—as the THI Receiver and FAS initially *861 suggested—a blanket prohibition against the Trustee using the co-client documents at trial (regardless of whether both co-clients are parties). At the conclusion of the September 17, 2014 hearing on this issue, the Court invited FAS and the THI Receiver (and anyone else objecting to co-client documents) to brief whether co-client documents can be used at all at trial or only where the co-clients are adverse parties. Both the THI Receiver and FAS filed memoranda. 10 In its memorandum, FAS misstates the issue the Court requested briefing on and then concedes it was unable to locate any authority on point. 11 The THI Receiver seems to concede the first point (i.e., coclient documents cannot be used at trial at all) and relies on commentary to the Restatement (Third) of the Law Governing Lawyers in support of the second point (i.e., co-client documents can only be used during subsequent adverse litigation between the co-clients). 12

In particular, the THI Receiver relies on comments (d) and (e). ¹³ Those two comments stand for the following propositions: (i) one co-client does not have authority to waive the attorney-client privilege with respect to another co-client's communications to the common lawyer; and (ii) one co-client may not invoke the attorney-client privilege in a subsequent proceeding in which the former co-clients are adverse. Neither of the comments to the Restatement supports the THI Receiver's argument that the Trustee should be precluded from using the co-client documents here.

As an initial matter, it is not clear the statement in comment (d) that one co-client can use co-client communications against the other in subsequent adverse litigation between them means that is the only circumstance in which co-client communications may be used. Perhaps there are other circumstances where it would be permitted. And neither party cites any authority that says there are not other circumstances. In any event, assuming co-client communications can only be used in

subsequent adverse litigation, the Court finds that this proceeding satisfies that requirement.

The co-client documents at issue implicate three parties. One the one hand, THMI is a co-client to all of the communications at issue. And, as has been point out many times, the Trustee (one of the Plaintiffs here) is standing in the shoes of THMI for purposes of this proceeding. On the other hand, either THI or FAS is the other co-client with respect to the communications at issue. FAS and the THI Receiver argue that any communications where THI is the co-client cannot be used since THI is not a party to this proceeding. ¹⁴

*862 FAS, however, is a party to this proceeding. It is important to note that FAS was the THI Receiver's agent and THI's litigation liaison in virtually (if not all) of the communications where THI is the co-client. More importantly, this proceeding involves the claims the Probate Estates were pursuing against THI and THMI in state court (such as fraudulent transfer claims), and as FAS explained in opposing a proposed settlement between the Trustee and THI Receiver, it is FAS—not the THI Receiver—that has the right and responsibility to defend THI against those claims, as well as the negligence claims that still remain pending in state court. So FAS, a party to this proceeding, is the real party in interest with respect to the co-client exception.

And the subject of this proceeding relates to the subject of the prior joint representation. The prior joint representation, of course, related to the defense of negligence actions by the Probate Estates, as well as the Probate Estates' efforts to collect on judgments they obtained in some of those actions. This Court required the Probate Estates to litigate those judgment collection efforts here. Plus, any control FAS exercised over THMI during the scope of the prior joint representation (whether between THI and THMI or FAS and THMI) relates to the Trustee's substantive consolidation claim here. ¹⁵ Accordingly, the Trustee is entitled to use the co-client documents during trial.

None of the parties will be excluded from trial when the co-client documents are being used

[3] Having determined that the Trustee can use the coclient documents at trial, the real issue is whether any of In re Fundamental Long Term Care, Inc., 515 B.R. 857 (2014)

the parties need to be excluded from the courtroom during their use. The THI Receiver proposes that any party who is not a co-client be excluded from the courtroom when the documents are being used. Understandably, the THI Receiver's objective is to keep the Probate Estates —his adversary in litigation still pending in state court from seeing documents that may reflect defense strategy for the negligence actions. Although the THI Receiver's proposal is reasonable on its face, the problem is none of the parties—other than the Trustee and FAS—are coclients. If the Court adopted the THI Receiver's proposal, none of the other Defendants would be able to crossexamine the Plaintiffs' witnesses who testify about the coclient documents. And GTCR, while not objecting to the use of the co-client documents specifically, says parties should not be permitted to use evidence against it when it is excluded from the courtroom. In the end, the Court concludes that it is not necessary for any of the parties to be excluded from the courtroom while the co-client documents are being presented.

There are three principal reasons why that is the case. First, based on the Court's in-camera review of the co-client documents, many of them—subject to certain portions being redacted—are not privileged in the first place. Second, even if some of the documents are attorney work product under Rule 26, 16 they do not reflect an attorney's mental impressions, opinions, or legal theories, and this is a case where the Trustee has a substantial need to use the documents and cannot *863 obtain the substantial equivalent of them without undue hardship. ¹⁷ Third, to the extent some of the documents are privileged, the Trustee has the right to waive the privilege with respect to THMI's own communications with its lawyers, so long as the communications relate only to THMI. The Court's ruling that the parties need not be excluded from the courtroom, however, is subject to one caveat.

In no case, should the Probate Estates be entitled to the defense strategy of THI and THMI in the negligence cases. That was the Court's primary concern in preventing the Trustee from disclosing the litigation files in the first place. And that concern still remains since some or all of the negligence cases are still pending. The Probate Estates should not be able to gain an advantage in the pending negligence cases simply by virtue of being a party to and present during the trial in this proceeding.

The Trustee has two options for keeping the Probate Estates from gaining access to defense strategy communications. First, if the Trustee believes the portions of an exhibit containing defense strategy are relevant to the claims in this case, she will be entitled to present that information at trial, but the Court will require that the Probate Estates (and their professionals) leave the courtroom. The Court does not anticipate this will be an issue since the Trustee has repeatedly said she does not intend to introduce defense strategy materials at trial. Second, if the Trustee wants to introduce exhibit that contains defense strategy because the non-defense strategy portions are relevant, she can simply redact the defense strategy portions. That should resolve the objecting party's principal concerns.

In an abundance of caution, the Court will impose two additional conditions on the use of the co-client documents: The Court will expressly find that no use of a document at trial will constitute a waiver of the attorney-client privilege or work product doctrine in any subsequent action or proceeding. And neither the co-client documents nor their contents may be used outside of this proceeding absent further order of this Court or another court of competent jurisdiction. Redaction of defense strategy, coupled with the foregoing conditions, will prevent any party from being prejudiced in the event a document admitted into evidence at trial later turns out to be subject to a nonwaivable privilege.

Conclusion

The Trustee is entitled to use all of the co-client documents at trial subject to the following limitations: (i) if the Trustee introduces a co-client document that contains strategy for the defense of the negligence actions pending in state court, then the Probate Estates (and their professionals) must be excluded from the courtroom or the defense strategy material must be redacted; (ii) no use of a document at trial will constitute a waiver of the attorney-client privilege or work product doctrine in any subsequent action or proceeding; and (iii) neither the co-client documents nor their contents may be used outside of this proceeding absent further order of this Court or another court of competent jurisdiction.

Accordingly, it is

In re Fundamental Long Term Care, Inc., 515 B.R. 857 (2014)

ORDERED:

- 1. The Trustee is entitled to use all of the exhibits identified on her list of confidential exhibits. The Trustee has until 9:00 a.m. on September 21, 2014 to (i) disclose to the THI Receiver and FAS any *864 exhibits she intends to use at trial that she believes contains strategy relating to the defense of state-court negligence action; and (ii) designate the portions of those exhibits she intends to redact. The THI Receiver and FAS have until 12:00 p.m. on September 21, 2014 to designate any other documents they believe should be redacted.
- 2. The parties shall meet and confer regarding the disputed documents. If the parties are unable to reach an agreement regarding the redaction and use of exhibits,

the parties shall submit the disputed exhibits to the Court by 1:00 p.m. on September 21, 2014. The Court reserves jurisdiction to make the final determination as to which exhibits should be redacted.

3. No use of a document at trial will constitute a waiver of the attorney-client privilege or work product doctrine in any subsequent action or proceeding. And neither the coclient documents nor their contents may be used outside of this proceeding absent further order of this Court or another court of competent jurisdiction.

All Citations

515 B.R. 857

Footnotes

- 1 Technically, THI and THMI were represented by the same lawyers in five of the six lawsuits. In the sixth lawsuit (one filed by the Estate of Nunziata), only THMI was a defendant.
- 2 In re Fundamental Long Term Care, Inc., 2012 WL 4815321, at *8 (Bankr.M.D.Fla. Oct. 9, 2012).
- 3 In re Fundamental Long Term Care, Inc., 489 B.R. 451, 477 (Bankr.M.D.Fla.2013).
- 4 And the Trustee does not argue that they could have.
- Adv. Doc. No. 892. The Trustee raised several grounds for why she should be permitted to use the documents. For instance, she says that some of the documents are not actually privileged even though she received them as part of the "co-client" production. Other documents she concedes may contain privileged information. For those documents, she says the Court should permit her to use redacted versions, or in the alternative, the Court should determine that public policy does not warrant keeping the documents confidential.
- 6 In re Fundamental Long Term Care, Inc., 489 B.R. at 476.
- 7 Id.
- It has been a consistent theme by FAS and others throughout the main bankruptcy case and this adversary proceeding that the Trustee and the Probate Estates are in cahoots. In FAS's view, the Trustee would like to see the Probate Estates rack up huge verdict in the state court negligence estates. That would result in larger claims in this case, which would increase the Defendants' ultimate exposure in this proceeding. And all of that would benefit the Trustee and her counsel since they will receive a percentage of any recovery in this proceeding.
- The Court has jurisdiction over this proceeding under 28 U.S.C. § 1334(b). This is a core proceeding under 28 U.S.C. § 157(b)(2)(H). Moreover, no party timely objected to this Court entering a final order or judgment in this case. An order objecting to the Court's authority to enter a final judgment was required to be filed by the deadline for responding to the complaint. Adv. Doc. No. 3 at ¶ 4. Accordingly, the parties are deemed to have consented to this Court entering a final order or judgment.
- Adv. Doc. Nos. 918 & 919. Other than the GTCR Group, none of the other Defendants filed memoranda. Adv. Doc. No. 920. And the GTCR Group's memoranda did not object to the documents being used, only that documents should not be used against it if it is excluded from the courtroom.
- In its memorandum, FAS frames the issue as: "whether prior compelled disclosure of attorney-client privileged materials to the Trustee in discovery under the co-client exception to the privilege now entitles the Trustee to unfettered use of the privileged and confidential materials at trial." Adv. Doc. No. 918 at ¶ 3. FAS then concedes it "has not found authority that would require a nexus between the adversity of the co-clients in litigation and the specific case in which the co-client privileged materials could or should be excluded or admissible." *Id.* at ¶ 4.
- 12 Adv. Doc. No. 919 at 1–2 (citing Restatement (Third) Law Governing Lawyers § 75 cmt. (2000)).
- 13 *Id.*

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- 14 FAS is a party. So it cannot make that same argument with respect to communications where it was the co-client.
- 15 FAS makes a point to stay this is not a disputed issue. Adv. Doc. No. 918 at 5. According to FAS, "[t]here is no dispute that FAS and Ms. Zack managed litigation against THMI in cases pending against FLTCH and/or its direct and indirect subsidiaries." Of course, there is a difference between managing litigation against THMI and controlling THMI.
- 16 Fed. R. Bankr.P. 7026(b)(3)(A).
- 17 *Id.*

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