AMERICAN BANKRUPTCY INSTITUTE

2018 Winter Leadership Conference

Judges' Round-and-Round

PLENARY SESSION

2018

2018 ABI WLC Judges Round and Round Program Topics

NAME OF JUDGE	TOPICS
Barash, Martin	**Mortgage Modification Mediation** Bankruptcy courts around the country have adopted loan modification mediation programs to address the difficulties encountered by consumer debtors during the Great Recession in negotiating modifications of their residential mortgage loans. This discussion will explore the benefits and challenges of these programs. This discussion welcomes both practitioners who have experience with these programs and those who do not, but may be interested in seeing these programs adopted in their jurisdiction.
Blumenstiel, Hannah	**Attorneys' Fees for Defending Fee Applications: Is there any wiggle room after Baker Botts LLP v. ASARCO LLC, 135 S. Ct. 2158 (2015)?** Baker Botts held unequivocally that professionals employed by a bankruptcy estate under 11 USC 327(a) were not entitled to fees incurred in defending their fee applications because such services benefited only the professionals and not the estate. Since that decision came down, a few cases have signaled ways to avoid its consequences.
Carey, Kevin	**What happens after a trademark licensor rejects the license?**
Collins, Dan	**SB 2282 proposes a change in the Bankruptcy Venue Statute. Good Idea or Not?** SB2282 was introduced in the U.S. Senate on January 8, 2018. Some are hoping a companion House Bill will soon follow. The Senate Bill will eliminate "domicile" as a basis for selecting venue in an entity's chapter 11 filing and would limit the current affiliate venue provisions. Is this a good or bad idea?

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Diehl, Mary Grace	**Make whole premiums -- when does a debtor have to pay the price?** Two circuit courts of appeal have weighed in on this issue, with opposite results. The Third Circuit in *Energy Future Holdings Corp.*, 842 F. 3D 247 (3d Cir. 2016) held that a debtor refinancing notes in connection with a Chapter 11 case was obligated to pay the make-whole premium, notwithstanding the automatic acceleration of the debt upon the filing of the Chapter 11 case as per the terms of the indenture. In contrast, the Second Circuit in *MPM Silicones, LLC,* 874 F. 3D 787 (2d Cir. 2017) held that the make whole premiums were unenforceable where an acceleration had already occurred since there could be no pre-payment or redemption under those circumstances and the language of the indenture did not specifically provide the premium was due notwithstanding the acceleration.
Dow, Dennis	**I sort of didn't object: Can I still be heard? Can I still appeal?**
Drain, Robert	**Plan injunctions: jurisdiction, Stern/Final order, consent/1141**
Fagone, Michael	**Husky and its aftermath**
Harwood, Bruce	**When is "Too Late?" Can a post-foreclosure auction, pre-foreclosure deed chapter 13 filing permit a debtor to cure and reinstate a foreclosed residential mortgage?**
Houser, Barbara	**Supreme Court Decision Discussion**
Isicoff, Laurel	**Proportionality in discovery**

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Thorne, Deborah	**Circuit split regarding whether a secured party holding collateral at the time the automatic stay is imposed is required to turn the collateral over to the debtor.** A circuit split has developed as to whether passive possession of secured collateral post-petition is a violation of the automatic stay under section 362(a)(3). The majority view holds that it is (7th, 2d, 9th, 8th) and the minority view (D.C. Circuit and 10th) holds that it is not. An attempt to overturn the earlier 7th Circuit ruling in *Thompson v. GMAC*, 566 F.3d 699 (7th Cir. 2009) is on direct appeal to the Seventh Circuit Court of Appeal in *In re Shannon,* 590 B.R. 467 (Bankr. N.D. Ill. 2018) and *In re Peake,* 588 B.R. 811 (Bankr. N.D. Ill. 2018). The Tenth Circuit recently affirmed its prior holding in *In re Cowen*, 849 F.3d 943 (2017), that only an affirmative act can be a violation of the automatic stay. *See Davis v. Tyson Prepared Foods Inc. (In re Garcia), 740 Fed.Appx 163* (10th Circuit, 2018). It seems likely that the cases which are pending before the 7th Circuit in a consolidated direct appeal or possibly the 10th Circuit's newest decision in *Garcia* might be the grounds for a petition for certiorari to the Supreme Court to consider the circuit split. In the meantime, what should a debtor do to obtain a return of a repossessed car or other property in the hands of his/her secured creditor and what position should the creditor take who is holding the collateral?
Wanslee, Madeleine	**Separate classification and favorable treatment of student loan debt in a Chapter 13 plan**

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NAME OF JUDGE	TOPICS
Wedoff, Gene	**Can Chapter 13 debtors deduct ongoing retirement contributions from the disposable income payable to creditors?** A BAPCPA amendment added a hanging paragraph to the end § 541(a)(7) of the Code, which sets out exclusions from property of the estate. The paragraph now reads as follows: (7) any amount—(A) withheld by an employer from the wages of employees for payment as contributions—(i) to— (I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986; (II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or (III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986; *except that such amount under this subparagraph shall not constitute disposable income as defined in section 1325(b)(2).* The hanging paragraph has been treated in different ways in bankruptcy decisions, as set out in In re Cantu, 553 B.R. 565, 572 (Bankr. E.D. Va. 2016): There are essentially three divergent lines of cases. The first line of cases holds that the debtor is not entitled to any deduction for voluntary retirement contributions, whether or not he or she was making voluntary retirement contributions pre-petition. In re Seafort, 669 F.3d 662, 674-75 (6th Cir. 2012); In re McCullers, 451 B.R. 498, 503-05 (Bankr. N.D. Cal. 2011); In re Prigge, 441 B.R. 667, 672-78 (Bankr. D. Mont. 2010). The second view, that voluntary retirement contributions may be continued post-petition as long as they are consistent with the debtor's pre-petition history of contributions, is represented by the Sixth Circuit Bankruptcy Appellate Panel's decision in In re Seafort, 437 B.R. 204 (6th Cir. B.A.P. 2010), aff'd, 669 F.3d 662 (6th Cir. 2012). The third line of cases, which is the majority view, concludes that Section 541(b)(7) allows the deduction, whether or not the debtor was making voluntary contributions prior to the bankruptcy filing, but subject to a determination of the debtor's good faith. In re Vanlandingham, 516 B.R. 628 (Bankr. D. Kan. 2014); In re Johnson, 346 B.R. 256, 263 (Bankr. S.D. Ga. 2006).

Problems in the Code I

By Prof. Susan E. Hauser

Separate Classification of Student Loan Debt in Chapter 13

An Examination of the Conflict Between § 1322(b)(1) and (5)

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Student loans, both public and private, are currently nondischargeable under § 523(a)(8) unless excepting the debt from discharge would impose an undue hardship on the debtor and the debtor's dependents. The present law is the product of a series of amendments to the Bankruptcy Code that parallels the development of the modern student loan industry.[1] These amendments have made § 523(a)(8) increasingly creditor-friendly, culminating with an amendment added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) extending nondischargeability to student loans made by private lenders.[2]

At the same time that discharging student loans has become more difficult, an enormous expansion in the amount of student loan debt has presented bankruptcy lawyers and judges with individual debtors who are genuinely unable to repay the full amount of their educational debt.[3] The tension between the restrictive language of the Bankruptcy Code and the reality of their caseloads has created pressure on both judges and lawyers to push the law in new directions to allow relief to overburdened debtors.

This article examines one such solution: the separate classification of student loan debt in chapter 13 plans, an "outside-the-box" treatment that enables consumer debtors to give preferential treatment to student loan debt. As in chapter 7, student loan debt is generally nondischargeable in chapter 13 cases[4] and does not have priority status.[5] Despite this, debtors may be able to use the provisions of chapter 13 to treat student loan debts more advantageously than other unsecured debts. This is typically accomplished by classifying the student loan claims separately from other unsecured claims, then making the full contract payment directly to the student loan creditor while making a reduced *pro rata* payment to other unsecured creditors through the plan.[6]

Conflict between § 1322(b)(1) and (5)

The relevant Code provisions for this purpose are § 1322(b)(1) and (5).[7] Section 1322(b)(1) allows a chapter 13 plan to "designate a class or classes of unsecured claims, as provided in section 1122," with the proviso that classification "may not discriminate unfairly" against any class. Section 1322(b)(5) permits a chapter 13 plan to "provide for the curing of any default ... and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due."

Because most student loans are long-term debts with payments that extend beyond the life of the plan, they fall within the subset of obligations governed by § 1322(b)(5). Read in isolation, this subsection permits the debtor to maintain contract payments on his or her student loans while relegating other unsecured debts to a lower *pro rata* payment as a separate class. Because this provides preferential treatment to student loan creditors, the issue then becomes whether § 1322(b)(5) controls over the conflicting "unfair discrimination" provision found in § 1322(b)(1).[8]

1 The first provision limiting the discharge of student loan debt did not appear until 1976, when certain government-backed student loans were made nondischargeable under the former Bankruptcy Act for a period of five years after the date that the loan first became due. During this five-year period, student loans continued to be dischargeable if disallowing the discharge would impose an undue hardship on the debtor or his or her dependents. These provisions were carried forward into the Bankruptcy Code of 1978, and the five-year provision was expanded to include a wider array of educational loans (any educational loan funded, made, insured or guaranteed by a governmental unit or funded by a nonprofit educational institution). The five-year limit was increased to seven years in 1990. The seven-year rule was eliminated in 1998, leaving undue hardship as the only avenue for the discharge of most educational debt. *See, e.g., Hemar Ins. Corp. of Am. v. Cox (In re Cox)*, 338 F.3d 1238, 1242-43 (11th Cir. 2003) (detailing the evolution of § 523(a)(8)).

2 Pub. L. No. 109-8, § 220, 119 Stat. 23 (2005).

3 *See, e.g., Carnduff v. United States Dept. of Educ. (In re Carnduff)*, 367 B.R. 120 (B.A.P. 9th Cir. 2007). After discharging $215,000 in private student loan debt, the debtors, a married couple, brought a second action to discharge an additional $350,000 in student loans owed to the government, for a stunning total of $565,000 in educational debt. The court allowed a partial discharge, finding it impossible for them to repay their loans in full "unless one or both of the debtors wins the lottery, receives a substantial inheritance, [or] finds a gold mine or a treasure trove in the backyard." 367 B.R. at 130.

4 11 U.S.C. § 1328(a)(2). Student loan debt has been nondischargeable in chapter 13 since 1990. *See In re Sharp*, 415 B.R. 803, 808 (Bankr. D. Colo. 2009) (citing Student Loan Default Prevention Initiative Act of 1990, Pub. L. 101-508, §§ 3001, 3007, 104 Stat. 1388, 1388-28 (1990)).

5 11 U.S.C. § 507. Because student loan debt does not have priority status, there is no requirement that it be paid in full through the chapter 13 plan pursuant to 11 U.S.C. § 1322(a).

6 For example, the debtors in *In re Webb*, 370 B.R. 418 (Bankr. N.D. Ga. 2007), proposed to maintain their regular monthly payments to student loan creditors while making only a 1 percent payout to other unsecured creditors.

7 Section 1322(b)(10), a provision added by BAPCPA, limits the payment of interest on nondischargeable unsecured claims in chapter 13 and is also a factor in some cases. Section 1322(b)(10) states that a chapter 13 plan may "provide for the payment of interest accruing after the date of the filing of the petition on unsecured claims that are nondischargeable under section 1328(a), except that such interest may be paid only to the extent that the debtor has disposable income available to pay such interest after making provision for *full* payment of all allowed claims." (emphasis added). The leading case dealing with the interplay between § 1322(b)(5) and (10) is *In re Freeman*, Case No. 06-10651-WHD, 2006 WL 6589023 (Bankr. N.D. Ga. Dec. 22, 2006), which concludes that debtors may ignore § 1322(b)(10) when they propose to cure and maintain student loans under § 1322(b)(5). *See* Cameron M. Fee, "An Attempt at Post-Mortem Revival: Has § 1322(b)(10) Been Euthanized?," XXXI *ABI Journal* 6, 38-39, 92-93, July 2012 (criticizing result in *Freeman*).

8 The conflicting arguments were nicely summed up by Judge Houston in *In re Boscaccy*: "The trustee's argument is that the debtors' proposals constitute unfair discrimination which is prohibited by 11 U.S.C. § 1322(b)(1). The debtors' position is that, regardless of § 1322(b)(1), they are allowed to separately classify and treat their student loans as proposed pursuant to the 'cure and maintain' provision set forth in § 1322(b)(5)." 442 B.R. 501, 505-06 (Bankr. N.D. Miss. 2010).

Decisions Addressing the Conflict

This problem has been discussed by a number of courts, with a minority of reported decisions finding that subsection (b)(5) trumps (b)(1), thereby completely excepting long-term debt payments from the unfair-discrimination analysis of subsection (b)(1).[9] Courts accepting this position allow the plan to cure defaults and maintain payments on student loans without regard for the position of other unsecured creditors. Under the majority view, however, subsection (b)(5) must be read in conjunction with (b)(1), with the result that a plan that provides for full payment of student loan obligations under (b)(5) must then be analyzed for unfair discrimination as required by (b)(1).[10]

The Code does not define "unfair discrimination," and courts have developed several multi-factor tests to enable this analysis. The most widely used test, the *Wolff/Leser* test,[11] has four components: "(1) whether the discrimination has a reasonable basis; (2) whether the debtor can carry out a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) whether the degree of discrimination is directly related to the basis or rationale for the discrimination."[12] A variation of the *Wolff/Leser* test was adopted in *In re Husted*, which added a fifth factor: an examination of "the difference between what the creditors discriminated against will receive as the plan is proposed, and the amount they would receive if there was no separate classification."[13]

The *Wolff/Leser* test has been criticized as offering "no real direction for determining the fairness of discrimination in any given instance,"[14] and other courts have attempted to develop more concrete alternatives.[15] The most prominent of these alternatives is the "baseline" test enunciated by the First Circuit Bankruptcy Appellate Panel (BAP) in *In re Bentley*,[16] which looked to the "principles and structure of Chapter 13" as the "baseline against which to evaluate discriminatory provisions for fairness."[17] The decision then enunciated four core principles: (1) absent an express grant of priority, unsecured creditors should share equally; (2) student loan obligations are not priority debts; (3) unless unsecured creditors are paid in full, the chapter 13 debtor must devote all disposable income to the plan; and (4) the facts may indicate that the debtor's interest in a "fresh start" trumps the creditors' claim to a *pro rata* share.

Regardless of the test that is applied, most courts have concluded that discrimination based on nothing more than nondischargeability is unfair.[18] However, "if the discrimination in question benefits the very creditors who are being discriminated against"—for example, by enabling the debtor to work—it may be considered fair.[19] At least one court has also found discrimination justifiable when, absent direct payments, the debtor would emerge from chapter 13 owing more on his or her student loans than he or she did before the case was filed.[20] Similarly, separate classification has been allowed when this would enable the debtor to participate in the Public Service Loan Forgiveness Program and write off $50,000 of otherwise nondischargeable debt.[21]

Impact of Projected Disposable Income Test

BAPCPA added a new wrinkle to this analysis by requiring that the projected disposable income of above-median income chapter 13 debtors be calculated with reference to the "means test" of § 707(b)(2), as opposed to the real numbers reflected on the debtor's Schedules I and J. Section 707(b)(2) requires the debtor to use hypothetical amounts specified in National and Local Standards issued by the Internal Revenue Service, creating the possibility that a debtor's projected disposable income under § 707(b)(2) might be less than his or her actual discretionary income. When this occurs, it is possible for the above-median debtor to devote 100 percent of his or her projected disposable income to unsecured creditors in the plan and still retain sufficient excess "discretionary" income to make contract payments on his or her student loans. This strategy has withstood challenge, even when student loans are paid in full and the dividend to other unsecured creditors is extremely low.[22]

Conclusion

On balance, the majority view adopts the best construction of the existing statute by reading subsection (b)(5) in light of (b)(1) and attempting to harmonize the conflict by imposing an unfair-discrimination analysis on chapter 13 plans that use § 1322(b)(5) to provide for full payment of student loan debts. The close placement of these provisions, coupled with the specific exclusion of subsection (b)(2) from § 1322(b)(5),[23] are indicators that Congress intended some interplay between (b)(5) and (b)(1) and could have avoided its intersection had Congress wished to do so. The statutory language remains confusing at best and challenges bankruptcy judges with an awkward and difficult piece of analysis. Congress could provide a clearer path by explaining the interplay between § 1322(b)(1) and (5) and expressly stating the conditions that allow a chapter 13 debtor to provide preferential plan treatment to student loan obligations. abi

9 *In re Johnson*, 446 B.R. 921 (Bankr. E.D. Wis. 2011); *In re Truss*, 404 B.R. 329, 333 (Bankr. E.D. Wis. 2009) ("If the plan provides for the cure of a default and maintenance of payments on a debt, the terms of which extend beyond the term of the plan, it is not for the court to determine whether this is fair to the other creditors or not.").

10 *In re Zeigafuse*, 2012 WL 1155680 (Bankr. D. Wyo. April 5, 2012); *In re Pracht*, 464 B.R. 486 (Bankr. M.D. Ga. 2012); *In re Boscaccy*, 442 B.R. 501 (Bankr. N.D. Miss. 2010); *In re Harding*, 423 B.R. 568 (Bankr. S.D. Fla. 2010); *In re Pora*, 353 B.R. 247 (Bankr. N.D. Cal. 2006); *In re Simmons*, 288 B.R. 737 (Bankr. N.D. Tex. 2003).

11 This test was adopted by the Eighth Circuit in *Mickelson v. Leser (In re Leser)*, 939 F.2d 669 (8th Cir. 1991), and by the Ninth Circuit Bankruptcy Appellate Panel in *Amfac Distrib. Corp. v. Wolff (In re Wolff)*, 22 B.R. 510 (B.A.P. 9th Cir. 1982).

12 *In re Webb*, 370 B.R. 418, 423 (Bankr. N.D. Ga. 2007).

13 142 B.R. 72, 74 (Bankr. W.D.N.Y. 1992).

14 *Bentley v. Boyajian (In re Bentley)*, 266 B.R. 229 (B.A.P. 1st Cir. 2001).

15 *See, e.g., In re Brown*, 152 B.R. 232 (Bankr. N.D. Ill. 1993), *rev'd*, 162 B.R. 506 (N.D. Ill. 1993); *In re Colfer*, 159 B.R. 602 (Bankr. D. Me. 1993). The issue was approached by the Seventh Circuit in *In re Crawford*, 324 F.3d 539, 542 (7th Cir. 2003), which pronounced that "[w]e haven't been able to think of a good test ourselves. We conclude, at least provisionally, that this is one of those areas of the law in which it is not possible to do better than to instruct the first-line decision maker, the bankruptcy judge, to seek a result that is reasonable in light of the purposes of the relevant law, which in this case is Chapter 13 of the Bankruptcy Code."

16 *Supra*, n.14.

17 *Id.* at 240.

18 *Groves v. LaBarge (In re Groves)*, 39 F.3d 212 (8th Cir. 1994); *Pracht, supra*, n.10; *Boscaccy, supra*, n.10 at 507 (noting that "the general view that discrimination based solely on nondischargeability is unfair"); *In re Gonzalez*, 206 B.R. 239 (Bankr. S.D. Fla. 1997).

19 *In re Kalfayan*, 415 B.R. 907, 910 (Bankr. S.D. Fla. 2009) (debtor's license to practice optometry was contingent on remaining current on her student loans).

20 *Webb, supra*, n.12.

21 *Pracht, supra*, n.10.

22 *In re Abaunza*, 452 B.R. 866 (Bankr. S.D. Fla. 2011) (plan did not unfairly discriminate when projected disposable income resulted in dividend of only 0.86 percent); *In re King*, 460 B.R. 708 (Bankr. N.D. Tex. 2011); *In re Sharp*, 415 B.R. 803 (Bankr. D. Colo. 2009); *In re Orawsky*, 387 B.R. 128 (Bankr. E.D. Pa. 2008).

23 Section 1322(b)(2) allows the plan to modify secured claims, with the exception of claims secured "only by a security interest in real property that is the debtor's principal residence."

Feature

By Anne Zoltani and Hon. Janice Miller Karlin

Examining § 362(a)(3): When "Stay" Means Stay

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Section 362(a), the broad statutory provision known as the automatic stay, prohibits (among other things) "any act to exercise control over property of the estate."[1] Competing considerations and statutory interpretations have resulted in a split of authority as to whether a creditor who passively retains an asset obtained pre-petition has "exercise[d] control"[2] in violation of the automatic stay. A majority of courts have held in the affirmative: The act of passively retaining an asset obtained pre-petition following a post-petition demand for turnover is exercising control and, accordingly, violates the automatic stay.[3] These courts have read the Bankruptcy Amendments and Federal Judgeship Act of 1984 (the "1984 Amendments") to expand § 362(a) to prohibit conduct that is "beyond obtaining possession,"[4] asserting that the 1984 Amendments infer this congressional intent to also "prevent creditors from retaining property of the debtor."[5]

A small minority of courts[6] have held that "the act of passively holding onto an asset"[7] post-petition, even after a demand for turnover, is not a violation of the automatic stay. In *Cowen*,[8] the U.S. Court of Appeals for the Tenth Circuit recently adopted the minority view, holding that "only affirmative acts ... to exercise control over property of the estate violate § 362(a)(3)."[9]

The Majority View

In *Weber*, the Second Circuit is the most recent circuit to join the growing majority of appellate courts in adopting the majority view.[10] The Second Circuit held that a secured creditor, intentionally retaining a debtor's pre-petition repossessed vehicle post-petition, "willfully" violates the automatic stay.[11] In interpreting § 362(a)(3), the Second Circuit first nodded toward faithful adherence to the text in examining the common meaning of *control*, reasoning that in the act of "keeping custody of the vehicle and refusing ... access to ... it, [the creditor] was 'exercising control'"[12] under the common meaning of the word. Accordingly, the creditor's retention of the vehicle violated the stay.

The Second Circuit explained that this conclusion was supported by policy considerations and the legislative history of § 362(a)(3).[13] In analyzing that legislative history, the court noted that the broad language of the 1984 Amendments was "consonant with [the Second Circuit's] understanding and the [U.S.] Supreme Court's interpretation that Congress intended to prevent creditors from retaining property of the debtor in derogation of the bankruptcy procedure and the broad goals of debtor protection."[14] The Second Circuit emphasized that the Bankruptcy Code's language pointed away from any congressional desire to impose an additional burden on the debtor or trustee to undertake "a series of adversary proceedings to pull together the bankruptcy estate."[15]

In *Thompson*,[16] the Fourth Circuit reached the same result. Specifically, it held that a creditor's refusal to return a repossessed vehicle upon the debtor's request was an exercise of control in violation of the automatic stay.[17] The creditor in *Thompson* had argued that it only "passively held the asset"[18] and that some additional action, such as selling or transferring, was needed to satisfy the Code's definition of exercising control. In support of this argument, the creditor relied on courts that had followed the minority view: Merely "retain[ing] possession"[19] is a not an act within the meaning of the Bankruptcy Code.

The Fourth Circuit, in holding that this reading was "at odds with the plain meaning of the

1 11 U.S.C.A. § 362(a)(3).
2 *Id.*
3 *See generally Weber v. SEFCU (In re Weber)*, 719 F.3d 72, 81 (2d Cir. 2013); *Thompson v. Gen. Motors Acceptance Corp. (In re Thompson)*, 566 F.3d 699, 703 (7th Cir. 2009); *In re Rozier*, 376 F.3d 1323 (11th Cir. 2004); *California Emp't Dev. Dep't v. Taxel (In re Del Mission Ltd.)*, 98 F.3d 1147, 1152 (9th Cir. 1996); *Knaus v. Concordia Lumber Co. (In re Knaus)*, 889 F.2d 773, 775 (8th Cir. 1989); *In re Sharon*, 234 B.R. 676, 681 (B.A.P. 6th Cir. 1999) (holding that retaining repossessed property is essence of "exercising control"); *In re Carrigg*, 216 B.R. 303, 305 (B.A.P. 1st Cir. 1998); *Mitchell v. BankIllinois (In re Mitchell)*, 316 B.R. 891 (S.D. Tex. 2004) (holding by district court in Fifth Circuit that retention of vehicle repossessed pre-petition, after demands for turnover, was violation of automatic stay); and *Carr v. Security Sav. & Loan Ass'n (In re Carr)*, 130 B.R. 434, 436 (D. N.J. 1991), *superseded by statute on other grounds* (holding by district court in Third Circuit that failure to return debtor's repossessed collateral upon bankruptcy filing violated automatic stay).
4 *Weber*, 719 F.3d at 80 (quoting *Thompson*, 566 F.3d at 702).
5 *Id.*
6 *See generally Williams v. Cowen (In re Cowen)*, No. 15-1413, 2017 WL 745596, at *5 (10th Cir. Feb. 27, 2017); *U.S. v. Inslaw (In re Inslaw)*, 932 F.2d 1467 (D.C. Cir. 1991); and *Harold Massey v. Chrysler Fin. Corp. (In re Massey)*, 210 B.R. 693, 696 (Bankr. D. Md. 1997) (holding by bankruptcy court in Fourth Circuit that retention of vehicle does not violate stay and vehicle's return is not required until debtor provides adequate protection).
7 *Id.* at *4 (citing *Thompson*, 566 F.3d at 703).
8 *Cowen*, 2017 WL 745596, at *1.
9 *Id.* at *5.
10 719 F.3d 72 (2d Cir. 2013).
11 *Weber*, 719 F.3d at 79.
12 *Id.*
13 *Id.* at 80-81.
14 *Id.* at 80.
15 *Id.*
16 *Thompson v. Gen. Motors Acceptance Corp. (In re Thompson)*, 566 F.3d 699 (7th Cir. 2009).
17 *Id.* at 703.
18 *Id.* at 702.
19 *Id.*

Code,"[20] examined the definition of "control," which has been defined as "to exercise restraining or directing influence over."[21] The court enumerated examples of acts that constitute "exercising control" (*e.g.*, "holding onto an asset" or "refusing to return it"[22]), and noted that to limit the reach of § 362(a)(3) to affirmative acts "would not be logical given the central purpose of reorganization,"[23] given congressional intent and "a fair reading of the plain language of the ... Code."[24]

The majority view also embraces the relationship between §§ 362(a)(3) and 542.[25] According to the majority, these sections work together to further "the goals of the bankruptcy regime" by grouping the debtor's property together, sheltering the estate from creditors' actions and "enabling the debtor to get the relief and fresh start" through "rehabilitat[ion] [of] ... credit and pay[ment] of ... [the] debts."[26] This reading supports a framework wherein § 542 creates a self-executing obligation for creditors to return assets to the estate, and § 362 provides a "remedy for failure to do so."[27]

In re Cowen

As the Tenth Circuit recently opined in *Cowen*, the analysis of the majority is not without reproach.[28] In *Cowen*, Jared Cowen (a chapter 13 debtor) initiated an adversary proceeding seeking damages for violations of the automatic stay against two creditors, Aaron Williams and Bert Dring.[29] Before the bankruptcy filing, Williams and Dring had each repossessed one of Cowen's trucks, a 2006 Kenworth T600 and a 2000 Peterbilt 379.[30] They refused to return the trucks to Cowen post-petition, even though the bankruptcy court had ordered them to do so.[31] Williams claimed he had put the Peterbilt in his own name shortly before Cowen's bankruptcy filing.[32] Dring claimed he sold the Kenworth to an unknown Mexican national for cash in an undocumented sale before the bankruptcy and could not return the collateral.[33] Accordingly, both creditors argued that there was no stay violation because Cowen's rights in the trucks had been terminated pre-petition.[34]

The bankruptcy court disagreed, finding that they "likely forged documents and gave perjured testimony."[35] The court further found that even had their testimony been credible, such actions were "ineffective to terminate [Cowen's] interest in the trucks" under state law[36] and, accordingly, concluded that their actions violated the automatic stay.[37] The district court affirmed the bankruptcy court, except as to the amount of damages,[38] but the Tenth Circuit reversed.[39]

> **[C]reditors ... may wait until receipt of both the bankruptcy filing notice and the demand for turnover in compliance with § 542(a) before promptly returning the debtor's asset.**

Plain Language of § 362(a)(3)

The Tenth Circuit began its analysis by noting that the "majority rule seems driven more by 'practical considerations' and 'policy considerations,' than a faithful adherence to the text."[40] First, the Tenth Circuit recognized the essential canon of statutory construction, that courts must begin and end their inquiry "with the language of the statute itself."[41] Next, the court dissected § 362(a)(3), noting that "'any act' is the prepositive modifier of both infinitive phrases" and that the term "'act' ... commonly means to 'take action' or 'do something.'"[42] Thus, some action is required to violate the automatic stay.[43] With these principles in mind, the Tenth Circuit held that § 362(a)(3) "stays entities from *doing* something ... to exercise control"[44] but does not cover "the act of passively holding onto an asset."[45] As the Tenth Circuit concisely noted, "[S]tay means stay, not go."[46]

According to the Tenth Circuit, the inclusion in the 1984 Amendments of the "control" provision suggested "that the drafters meant to distinguish the newly prohibited 'control' from the already prohibited acts to obtain 'possession'" in order to reach non-possessory conduct."[47] The Tenth Circuit also acknowledged what it termed the majority courts' "best argument": Section 362 "should be read in conjunction with ... § 542."[48] However, the Tenth Circuit was not persuaded by this line of reasoning; once again, relying on its reading of the statute's language, it held "there [was] ... no textual link between" these two sections.[49] Finally, the Tenth Circuit held that in the absence of Congress's explicit direction, its conclusion as to the "intended meaning" of § 362(a)(3) was reached by "adhering to the text" of the Bankruptcy Code.[50] Accordingly, the Tenth Circuit adopted

20 *Id.*
21 *Id.* (citing *Merriam-Webster's Collegiate Dictionary* (11th ed. 2003).
22 *Id.* (holding that these acts "all fit within th[e] definition of ["exercising control"], as well as within the common-sense meaning of the word.").
23 *Id.*
24 *Id.* at 707.
25 *Id.* at 702; *Weber v. SEFCU (In re Weber)*, 719 F.3d 72, 79 (2d Cir. 2013).
26 *Thompson*, 566 F.3d at 702.
27 *Abrams v. Sw. Leasing & Rental Inc. (In re Abrams)*, 127 B.R. 239, 242-43 (B.A.P. 9th Cir. 1991).
28 *Williams v. Cowen (In re Cowen)*, No. 15-1413, 2017 WL 745596, at *1 (10th Cir. Feb. 27, 2017).
29 *Cowen v. WD Equip. LLC (In re Cowen)*, No. 13-1622-EEB, at *4 (Bankr. D. Colo. Aug. 18, 2014), *aff'd, rev'd and rem'd on other grounds sub. nom., Williams v. Cowen (In re Cowen)*, 549 B.R. 774, 780 (D. Colo., 2015), *rev'd*, 2017 WL 745596, at *4. Due to the debtor's lack of regular income, which was primarily caused by his loss of the use of those trucks to produce income, the bankruptcy court dismissed the bankruptcy case but retained jurisdiction over the adversary proceeding. *Id.* at *6.
30 The bankruptcy court found that repossession of the Kenworth was initiated by Dring under false pretenses and involved Dring "brandishing a can of mace" and threatening violence against Cowen and his young son. *Id.* at *9.
31 *Id.* at *10.
32 *Id.* at *4.
33 *Id.* Although Dring alleged at trial that documentation of the transfer did not exist, Dring submitted a bill of sale, which purported to show that the Kenworth had been sold to a "Mr. Garcia." *Id.*
34 *Id.* at *6.
35 *Id.* at *16.
36 *Id.* at *6.
37 *Id.*
38 *Williams v. Cowen (In re Cowen)*, 549 B.R. 774, 780 (D. Colo. 2015), *rev'd*, 2017 WL 745596, at *4 (recognizing that bankruptcy court adopted majority view, which Tenth Circuit Bankruptcy Appellate Panel had also followed).
39 *Williams v. Cowen (In re Cowen)*, No. 15-1413, 2017 WL 745596, at *1 (10th Cir. Feb. 27, 2017).
40 *Id.* at *4 (internal citations omitted).
41 *Id.* (quoting *Ransom v. FIA Card Servs. NA*, 562 U.S. 61 (2011)).
42 *Id.* (quoting *New Oxford American Dictionary* 15 (3d ed. 2010)).
43 *Id. See also In re Young*, 193 B.R. 620, 625 (Bankr. D. D.C. 1996) (examining definition of "exercise" in support of conclusion that exercise of control does not reach passive act of continuing to possess property).
44 *Cowen*, 2017 WL 745596, at *4.
45 *Id.* (citing *Thompson v. Gen. Motors Acceptance Corp. (In re Thompson)*, 566 F.3d 699 (7th Cir. 2009)).
46 *Id.*
47 *Id.* at *5 (citing Ralph Brubaker, "Turnover, Adequate Protection, and the Automatic Stay (Part II): Who Is Exercising Control Over What?," 33 No. 9 *Bankruptcy Law Letter NL* 1 (September 2013)).
48 *Id.*
49 *Id.*
50 *Id.*

continued on page 61

Examining § 362(a)(3): When "Stay" Means Stay

from page 21

the minority view that only affirmative acts to exercise control over property of the estate will violate § 362(a)(3).[51]

Post-*Cowen* Implications

Although those courts following the majority view discuss the statute's language, their analysis of the Bankruptcy Code's text is limited to that of the meaning of the phrase "exercise control." At the time of the publication of this article, no other cases have closely examined the significance of § 362(a)'s "any act" modifier language to highlight an affirmative-versus-passive distinction in § 362(a)(3), as *Cowen* did. *Cowen* also sheds light on the conceivable shortcomings of the majority view and brings to the fore the circuit split on this issue (and perhaps a test case for the Supreme Court).

As a practical matter, this issue typically arises in the context of a creditor's post-petition retention of a chapter 13 debtor's vehicle following a pre-petition repossession. For practitioners advising debtors in this situation, a best practice in any jurisdiction is to begin by making an immediate request to the creditor in writing (and orally), pursuant to § 542(a), to turn over the asset (accompanied with a warning about possible sanctions for a failure to comply). Debtors in jurisdictions that have not reached this issue or have adopted the minority view should also file an immediate motion for turnover and seek an emergency hearing (including any allegations of a creditor's affirmative post-petition acts if they hope to seek sanctions under § 362(a)(3)). If there is no basis to allege any affirmative act by a creditor, *Cowen* suggests that a debtor should seek turnover under § 542(a) and, if the creditor fails to obey, pursue sanctions under § 105(a) to carry out § 542(a)'s "shall deliver" directive.

Conversely, for those practitioners advising creditors in any jurisdiction, creditors should promptly return a debtor's asset upon receipt of a notice of bankruptcy (unless the debtor's legal or equitable interest in the asset was terminated pre-petition or a creditor has other defenses, such as adequate protection or inconsequential value to the estate). If the creditor has terminated the debtor's interest pre-petition, creditors' counsel should convey proof immediately upon a demand for turnover.

Cowen also suggests that creditors in jurisdictions that have adopted the minority view may wait until receipt of both the bankruptcy filing notice and the demand for turnover in compliance with § 542(a) before promptly returning the debtor's asset. That being said, creditors should be careful to ensure that they do not commit any affirmative acts to "exercise control" over a debtor's asset following the bankruptcy filing, as any affirmative act could subject them to potential sanctions under § 362(a)(3). abi

51 *Id.* The Tenth Circuit noted that a "damage award may be sustainable under ... section 105(a)."

Last in Line

By Hon. Deborah L. Thorne and Brett Newman[1]

What's Next After *Husky v. Ritz*: Has Pandora's Box Been Opened?

Hon. Deborah L. Thorne
U.S. Bankruptcy Court (N.D. Ill.); Chicago

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Hon. Deborah Thorne is a bankruptcy judge in the Northern District of Illinois and serves as ABI's Vice President-Communication and Information Technology. Brett Newman is a recent graduate of the University of Illinois College of Law in Champaign, Ill.

The U.S. Supreme Court granted *certiorari* in *Husky International Electronics Inc. v. Ritz* to resolve a circuit split, but the decision left many more questions in its aftermath. The full scope of *Husky*'s impact is unknown, but several issues that are likely to follow the Supreme Court's decision stand out.

Background

The facts in *Husky* are unique but relatively straightforward.[2] For a number of years, Husky International Electronics sold electronic device components to Chrysalis Manufacturing Corp., a company controlled by Daniel Ritz (the debtor).[3] Chrysalis did not pay for all of the goods it received, and Ritz transferred Chrysalis' assets to other entities controlled by him.[4] Husky then sued Ritz, attempting to hold him personally liable for Chrysalis' debt. The suit eventually led to Ritz filing a chapter 7 petition. Husky responded with an adversary complaint, claiming Ritz was liable for Chrysalis' debt and that the debt owed to it was not dischargeable under § 523 of the Bankruptcy Code.[5] The graphic illustrates the relationship among Husky, Ritz and Ritz's entities.

The bankruptcy court rejected these claims.[6] The district court affirmed, holding that Ritz was personally liable but that Husky could still not prevail under § 523(a)(2)(A), which excepts debts from discharge "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...."[7] The Fifth Circuit also affirmed and held that a misrepresentation is needed to show actual fraud in § 523(a)(2)(A).[8] In doing so, the Fifth Circuit rejected the Seventh Circuit's decision in *McClellan v. Cantrell*, in which Judge Richard Posner found that "actual fraud" in § 523(a)(2)(A) *does not* require a misrepresentation.[9] After the Fifth Circuit decided *Husky*, the First Circuit sided with the Seventh Circuit,[10] deepening the circuit split.

The Supreme Court granted *certiorari* in *Husky International Electronics Inc. v. Ritz* to resolve whether "actual fraud" in § 523(a)(2)(A) of the Bankruptcy Code requires a misrepresentation, and thus resolve the circuit split. On May 16, 2016, the Court ruled by a 7-1 vote[11] that fraudulent conveyances, like Ritz's alleged scheme, are within the scope of "actual fraud" in § 523(a)(2)(A).[12]

Justice Sonia Sotomayor delivered the opinion of the Court, which focused on two main points to justify its reversal of the Fifth Circuit's decision. First, the addition of "actual fraud" to § 523(a)(2)(A) in 1978 suggests that the phrase must include actions other than just false pretenses or false representations.[13] Second, the Court reasoned that the common law understanding of fraud, going all the way back to the *Statute of 13 Elizabeth*, included fraudulent conveyances.[14] The Court reversed the Fifth Circuit and remanded to decide, among other issues, "whether the debt to Husky was 'obtained by' Ritz'[s] asset-transfer scheme."[15]

Justice Clarence Thomas wrote a dissent that focused heavily on the "obtained by" issue, specifically that § 523(a)(2)(A) applies only at the *inception* of a debt, which was not the case in *Husky*.[16] He followed that reliance on the debtor's misrepresentation was required to satisfy § 523(a)(2)(A).[17] Because Ritz did not fraudulently induce Husky to sell goods to Chrysalis, Husky could not support a claim under § 523(a)(2)(A).[18]

Implications

While *Husky* answers the question of whether "actual fraud" requires a misrepresentation, several other questions are left in *Husky*'s wake.

1 Disclaimer: None of the statements contained in this article constitute the official policy of any judge, court, agency or government official or quasi-governmental agency. The authors express their gratitude to Prof. **Charles J. Tabb** of the University of Illinois College of Law and **Jasmine Reed**, a law clerk to Hon. **Pamela Pepper** of the U.S. District Court for the Eastern District of Wisconsin, for their suggestions and insights.
2 *See Husky Int'l Elecs. Inc. v. Ritz (In re Ritz)*, 787 F.3d 312, 314 (5th Cir. 2015).
3 *Id.*
4 *Id.* Ritz had varying degrees of ownership in the transferee entities.
5 *Id.* Husky's § 523 actions rest on a veil-piercing theory, where Husky attempted to hold Ritz liable for the companies that he controlled. This issue will need to be decided on remand for a § 523 claim to be successful.
6 *Husky Int'l Elecs. Inc. v. Ritz (In re Ritz)*, 459 B.R. 623 (Bankr. S.D. Tex. 2011).
7 *Husky Int'l Elecs. Inc. v. Ritz (In re Ritz)*, 513 B.R. 510 (S.D. Tex. 2014).
8 *Husky*, 787 F.3d at 321. The Fifth Circuit did not discuss, however, whether Ritz was personally liable.
9 *Id.*; *see McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000). In *McClellan*, the creditor sold assets to the debtor's brother, who subsequently transferred them to his sister (the debtor) for only $10. *Id.* at 892. The debtor then sold the assets for $160,000. *Id.* Then she filed a chapter 7 petition. *Id.* The Seventh Circuit found that a misrepresentation was not required to except a debt from discharge under § 523(a)(2)(A). *Id.* at 893. Judge Posner wrote that by participating in the fraudulent-transfer scheme, the debtor "obtained" assets by fraud and incurred a debt. *Id.* at 895.
10 *Sauer Inc. v. Lawson (In re Lawson)*, 791 F.3d 214 (1st Cir. 2015).
11 Only eight justices participated in the decision due to Justice Antonin Scalia's death in February 2016.
12 *Husky Int'l Elecs. Inc. v. Ritz*, 136 S. Ct. 1581 (2016).
13 *Id.* at 1586.
14 *Id.* at 1586-88.
15 *Id.* at 1589, n.3.
16 *Id.* at 1591 (Thomas, J., dissenting).
17 *Id.* (Thomas, J., dissenting).
18 *Id.* at 1592 (Thomas, J., dissenting).

Some of these issues may be particularly troublesome for bankruptcy courts. Most notably, the inclusion of fraudulent transfers under "actual fraud" significantly expands the scope of potential § 523(a)(2)(A) actions, leaving bankruptcy courts to deal with an influx of § 523(a)(2)(A) adversary proceedings. Given the peculiar factual situation in *Husky* and the unresolved "obtained-by" issue, the scope of *Husky*'s effects is unclear. Below are some of the issues that may follow from the increase in § 523(a)(2)(A) actions.

Unresolved Questions

The Supreme Court's decision was a narrow one, limited to the finding that "actual fraud" under § 523(a)(2)(A) *does not* require a misrepresentation. The question of whether the debt owed to Husky was "obtained by" Ritz's transfer scheme remains open.[19]

In its limited discussion on the issue, the Court stated that a transferor does not "obtai[n]" debt via a fraudulent conveyance, but a transferee *can* "obtai[n]" assets "by" participating in a fraud with the requisite intent.[20] If the transferee then files for bankruptcy, the debts that are "traceable to" the fraud are nondischargeable.[21] Despite its commentary on the issue, the Court stopped short of determining whether Ritz's debt was "obtained by" the transfer scheme. This might not stop creditors, however, from latching onto what appears to be the majority's *dicta* when trying to satisfy the "obtained by" requirement.

This open issue is likely to spawn similar litigation, with lower courts left to decide whether a specific transferee "obtain[s]" a debt "by" receiving a fraudulent conveyance.[22] On remand, the Fifth Circuit may very well deny Husky's § 523(a)(2)(A) claim again — this time on the basis that Ritz's alleged debt to Husky was not "obtained by" the fraudulent-transfer scheme.

Does this mean that bankruptcy courts can continue to deny § 523(a)(2)(A) claims similar to Husky's if the debt was not "obtained by" actual fraud? Bankruptcy courts will need to examine whether the nexus between the debtor and the offended creditor is sufficient to support a § 523(a)(2)(A) action. Despite the Court answering the question that "actual fraud" in § 523(a)(2)(A) does not require a misrepresentation, the "obtained by" issue is likely to leave lower courts split on what to do with *Husky*-type cases.

Two Bites at the Apple

Section 727(a)(2)(A) of the Bankruptcy Code provides a remedy for all creditors when there are fraudulent transfers, but those actions are limited to transfers occurring within a year before filing the petition.[23] Section 523(a)(2)(A), which covers fraudulent transfers post-*Husky*, contains no such limitation. This gives creditors a possible second bite at the apple in preventing the discharge of debts owed to them. In addition, it could erode the protection of the one-year reach-back period in § 727(a)(2)(A).

Will this result in many more § 523(a)(2)(A) actions when § 727(a)(2)(A) is the more appropriate option? Section

19 *Id.* at 1589 n.3. Whether Husky could pierce the corporate veil and hold Ritz individually liable was also an open question that would need to be decided on remand.
20 *Id.* at 1589.
21 *Id.*

22 For example, the Seventh Circuit has already addressed this question in *McClellan v. Cantrell.* In *McClellan*, the court acknowledged that a knowing recipient of a fraudulent transfer may obtain assets by fraud, and a debt "arises by operation of law" from the transferee's fraud. 217 F.3d at 895. The court determined that this debt would not be dischargeable under § 523(a)(2)(A). *Id.*
23 "The court shall grant the debtor a discharge, unless ... the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed ... property of the debtor, within one year before the date of the filing of the petition."

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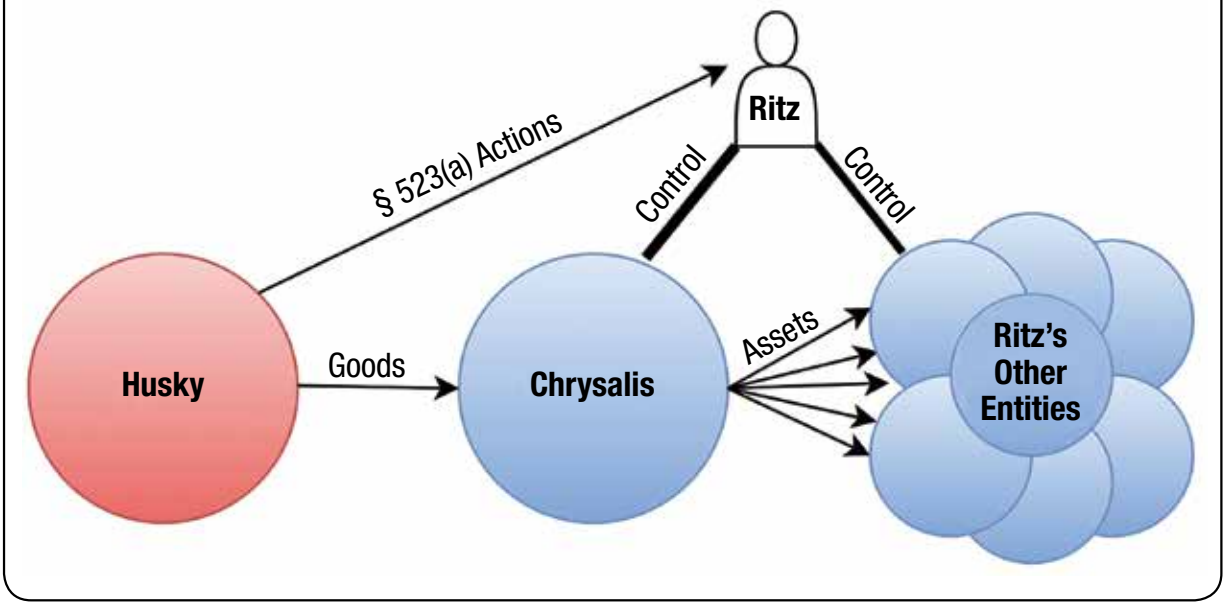
The Relationship Among Husky, Ritz and Ritz's Other Entities



Last in Line: What's Next After Husky*: Has Pandora's Box Been Opened?*

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727(a)(2)(A) was clearly drafted to respond to fraudulent transfers,[24] but it is not so clear for § 523(a)(2)(A).

Organizing § 523(a)(2)(A) Actions

Section § 523(a)(2)(A) is meant to except specific debts owed to individual creditors from discharge. When the fraud at issue is related to the inception of the debt, it is not difficult to tie the debt to the fraud. The same cannot be said for subsequent fraudulent transfers that are far removed from the inception of a debt. Given the decision in *Husky*, however, there will likely be many § 523(a)(2)(A) actions that are not easily tied to a particular debt owed to one creditor. Some likely issues that will follow are best shown by a hypothetical.

For example, consider a situation similar to *Husky*.[25] An individual (the transferor) owes three creditors $1,000 each. The transferor realizes that he is unable to pay his debts, and he transfers his last $300 to his niece (the transferee). Assume, as will likely be the case in these types of actions, that the $300 is not easily attributed to any one of the three individual creditors.[26] The transferee files a chapter 7 petition, and all of the transferor's creditors want to prevent the transferee from discharging her debt. Because the transferee received only $300 in fraudulent transfers, does only the winner of the proverbial "race to the courthouse" get to except its debt from discharge? If not, which seems to be the only fair answer, how does a bankruptcy court organize competing § 523(a)(2)(A) actions? What happens if one of the creditors does not show up?[27] If the creditors are successful, how much of the debts owed to them can be excepted from discharge?[28] The questions do not end here, and bankruptcy courts will be left to determine an equitable way to deal with these issues.

Changing the facts slightly, consider that there are now 100 creditors, most of which have considerable resources and are willing to file § 523 adversary complaints. Given that the fraudulent transfers cannot be specifically tied to the debt of any of the 100 creditors, all of them seek to file § 523(a)(2)(A) actions to prevent the transferee from discharging the debt that is owed to them. Surely it would not be economical or practical for 100 separate adversary proceedings to be initiated, seeking to except each separate debt from discharge. How will bankruptcy courts deal with this situation? Because the fraudulent transfers are not specifically tied to any of the 100 creditors, it would make sense for one action to be brought on behalf of all of the creditors.

The Bankruptcy Code incorporates provisions to allow one action to be brought on behalf of all the creditors, specifically §§ 548 and 727(a). In contrast, an action under § 523(a) benefits only the creditor that pursues it. The collective remedies in §§ 548 and 727(a) would surely be the more economical, equitable and practical approach for creditors to recover in the above example. These collective remedies provide a remedy for the benefit of all when the fraudulent transfers at issue are not directly attributable to any one single creditor. If the trustee does not pursue the above options, however, it leaves the door open for individual creditors to use § 523(a) for fraudulent transfers.

What Now?

Creditors will quickly respond to the Supreme Court's expansive reading of § 523(a)(2)(A), and it will be up to bankruptcy courts (absent further decisions from the courts of appeals) to respond to the increased use of the exception to discharge. The scope of the impact is unknown, but one thing is for sure: "Actual fraud" in § 523(a)(2)(A) includes receiving fraudulent transfers. Will this open Pandora's box, or is it much ado about nothing? abi

24 *Id.*

25 A similar hypothetical was posed by Hon. **Eugene R. Wedoff** (ret.), ABI's President-Elect, in a recent webinar. *See* "Experts Discuss Supreme Court's Ruling in *Husky International Electronics Inc. v. Ritz* and Its Impact on Fraudulent Conveyance Litigation," ABI Media Webinar (May 18, 2016), *available at* abi.org/educational-brief/experts-discuss-supreme-courts-ruling-in-husky-international-electronics-inc-v.

26 This may not be the case if, for example, if the transferor conveyed one of the creditor's goods to the transferee. In that case, the affected creditor may be the only one with a viable § 523(a)(2)(A) action.

27 *See* ABI Media Webinar, *supra* n.25. In his answer to Judge Wedoff's question, Prof. Anthony Casey of the University of Chicago Law School asked what would happen if only one creditor shows up.

28 *Id.* In this type of hypothetical situation, Judge Wedoff asked how much of the debt owed to each creditor would be nondischargeable.

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ABI EXCLUSIVE

May 31, 2018

Penalties for Fraud Are Nondischargeable Despite Chapter 13's 'Superdischarge'

> Fraudsters get no sympathy from the Sixth Circuit on dischargeability.

Penalties for fraudulently obtaining government benefits are nondischargeable despite the so-called superdischarge in chapter 13, according a May 29 opinion from the Sixth Circuit.

The circuit court was reviewing two cases with nearly identical facts. In both cases, an individual fraudulently obtained unemployment benefits by failing to disclose employment income. After discovering fraud, the state imposed orders of restitution and penalties for fraudulently obtaining unemployment benefits.

The restitution and penalties for one debtor were approximately $6,900 and $27,000, respectively, and $4,300 and $16,700 for the other. In other words, the penalties were about four times larger than the benefits that were fraudulently obtained.

In the debtors' chapter 13 cases, the state objected to the dischargeability of both the restitution awards and the penalties. The debtors conceded that the restitution awards were nondischargeable under Section 523(a)(2)(A) as money obtained by "false pretenses, a false representation, or actual fraud."

However, the debtors argued that the penalties were dischargeable in chapter 13 because they fell under Section 523(a)(7) as a "fine, penalty, or forfeiture payable" to a governmental unit that "is not compensation for actual pecuniary loss."

Although debts covered by Section 523(a)(7) are ordinarily nondischargeable, the superdischarge in Section 1328(a)(2) makes (a)(7) penalties dischargeable once chapter 13 debtors complete their plan payments. (Section 523(a)(2) debts are not covered by the superdischarge in Section 1328(a)(2) and remain nondischargeable in chapter 13.)

One bankruptcy judge ruled that the penalties were dischargeable, and the other held that they were not. On appeal in district court, the penalties were held nondischargeable.

Circuit Judge Eugene E. Siler, Jr. concluded that the penalties were nondischargeable.

Judge Siler was most persuaded by *Cohen v. de la Cruz*, 523 U.S. 213 (1998), where the Supreme Court held that treble damages for fraud are nondischargeable under Section 523(a)(2). He described *Cohen* as holding that "penalties associated with fraud should be regarded as essentially the same as the fraud itself."

Judge Siler rejected several arguments offered by the debtors. To the contention that exceptions to discharge are construed strictly against the creditor, he said that bankruptcy benefits the "honest but unfortunate" debtor.

The debtors relied on the rule of construction that a more specific statute, like Section 523(a)(7), should control over the more general provision in Section 523(a)(2). However, Judge Siler found no authority for the proposition that a debt may not be covered by two subsections in Section 523(a). Indeed, he said the subsections are not mutually exclusive.

Significantly, Judge Siler read the Supreme Court's recent decision in *Husky International Electronics Inc. v. Ritz*, 136 S. Ct. 1581 (2016), to mean that a debt can be nondischargeable under both subsections (a)(2) and (a)(7).

Judge Siler held that the penalties arose "from fraud perpetrated against the Agency," thus making the penalties nondischargeable under subsection (a)(2).

In *Husky*, the Supreme Court held that a debt can be nondischargeable for "actual fraud" under Section 523(a)(2)(A) even if the debtor made no misrepresentation to the creditor. To read ABI's discussion of *Husky*, click here.

Opinion Link

View Opinion

Case Details

Judge Name	Eugene E. Siler, Jr.
Case Citation	Andrews v. Michigan Unemployment Insurance Agency, 16-2383 (6th Cir. May 29, 2018)
Case Name	Andrews v. Michigan Unemployment Insurance Agency
Case Type	Consumer
Court	6th Circuit
Bankruptcy Tags	Claims Consumer Bankruptcy Discharge/Dischargeability

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An insightful writer known for his authoritative take on legal developments affecting bankruptcy practice, Bill Rochelle published for Bloomberg every day from 2007 through 2015.

Prior to his second career in journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP.

By The Numbers

Total cases in system	1026
Business Cases	389

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ABI EXCLUSIVE

August 11, 2017

Presumptively Fraudulent Transfer Isn't Enough to Appoint a Trustee, First Circuit Holds

> First Circuit is uncharacteristically lenient on debtors in the context of a motion for a trustee.

The First Circuit, not known for being easy on debtors, upheld a flexible approach not requiring bankruptcy courts to appoint chapter 11 trustees reflexively just because transfers seem fraudulent at first blush.

The case involved an individual debtor who owned two gasoline stations. He and the stations were in financial distress. Before filing his chapter 11 petition, he transferred the stations, one to a family trust and another to a corporation he controlled. Both of the transfers were presumptively fraudulent under Puerto Rico law.

In chapter 11, the debtor amended his schedules several times. Charitably speaking, he was sloppy. One creditor, who sought appointment of trustee, contended that the debtor was failing to disclose assets and transfers.

The bankruptcy judge denied the creditor's motion for appointment of a trustee under Section 1104(a), where fraud is listed as one of the rounds for ousting the debtor in possession. The Bankruptcy Appellate Panel upheld denial of the trustee motion.

The creditor fared no better in the First Circuit, where Circuit Judge David J. Barron handed down an opinion on Aug. 9 upholding the lower courts.

Although the transfers were presumptively fraudulent because they were made to family for little or no consideration, Judge Barron could not upset the bankruptcy court's fact-finding that the transfers had "no materially adverse impact on the bankrupt estate" because the separately incorporated gasoline stations had negative net worth.

Adopting a "totality of the circumstances" test, Judge Barron said there is no "authority to suggest that, in evaluating the totality of the circumstances, the effect of the transfer on the estate's value is an impermissible consideration under Section 1104(a)(1)."

Next, Judge Barron rejected the creditor's reliance on *Husky International Electronics Inc. v. Ritz,* 136 S. Ct. 1581, 194 L. Ed. 2d 655, 84 U.S.L.W. 4270 (2016), where the Supreme Court held that a debt can be nondischargeable under Section 523(a)(2)(A) even if the debtor made no misrepresentation to the creditor. He said that *Husky* does not purport to address what constitutes "fraud" under Section 1104(a)(1).

The debtor explained that he made the two transfers "to protect his assets from the aggressive collection actions of just one unsecured creditor," not the creditor that sought a trustee. The creditor moving for a trustee contended that the debtor's admission showed the type of fraudulent intent requiring appointment of a trustee.

Judge Barron said there was "no clear authority, from this or any other court," to support the idea that motivation to protect an asset from one creditor "for the benefit of other creditors automatically makes his transfers fraudulent for the purposes of Section 1104(a)(1)."

Opinion Link

View Opinion

[+] Feedback

Case Details

Judge Name David J. Barron

Case Citation	United Surety & Indemnity Co. v. Lopez-Munoz (In re Lopez-Munoz), 16-9007 (1st Cir. Aug. 9, 2017)
Case Name	In re Lopez-Munoz
Case Type	Business
Court	1st Circuit
Bankruptcy Tags	Bankruptcy Litigation Fraudulent Transfers Business Reorganization

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Supreme Court Cases	58

[+] Feedback

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ABI EXCLUSIVE

October 18, 2018

Tenth Circuit Opinion Can Be the Springboard for a 'Cert' on the Automatic Stay

> Circuit split is widening on whether inaction can be a violation of the automatic stay.

Predictably, the Tenth Circuit reaffirmed a deepening circuit split yesterday by holding that the automatic stay does not prevent a statutory worker's compensation lien from attaching automatically after bankruptcy to a recovery in a lawsuit. Yesterday's ruling sets up an opportunity for the Supreme Court to resolve the split and decide whether the automatic stay is really automatic.

Yesterday's decision in *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, 17-3247 (10th Cir. Oct. 17, 2018), was a foregone conclusion given *WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017), where the Tenth Circuit held last year that passively holding an asset of the estate in the face of a demand for turnover does not violate the automatic stay in Section 362(a)(3) as an act to "exercise control over property of the estate."

As the Tenth Circuit said yesterday, *Cowen* means that an "'act' for the purposes of [Section] 362(a)(3) is limited to affirmative conduct." The appeals court said that the automatic stay did not apply in *Garcia* because the "subrogation lien arose solely by operation of law."

In the lower court in *Garcia*, Bankruptcy Judge Robert E. Nugent of Wichita, Kan., reluctantly held, contrary to two prior decisions of his own, that the automatic stay did not prevent a statutory worker's compensation lien from attaching automatically after bankruptcy to a recovery in a lawsuit. Judge Nugent certified the case for direct appeal, and the circuit accepted the invitation.

The circuit court's decision in *Garcia* allows the lien to attach automatically despite the policy in Section 552(a), which precludes a "security interest" from attaching to property acquired after filing, with exceptions.

According to the transcript of oral argument in *Garcia* on September 26, the three-judge panel did not seem receptive to the idea of a rehearing *en banc*, which would allow the Tenth Circuit to revisit *Cowen*. If the trustee in *Garcia* is bent on further appellate review, he may opt for filing a petition for *certiorari* and bypass an attempt at rehearing *en banc*.

The Tenth Circuit is in accord with the District of Columbia Circuit in holding that inaction does not violate the automatic stay. The Second, Seventh, Eighth, Ninth and Eleventh Circuits hold to the contrary, having ruled that a lender or owner must turn over repossessed property immediately or face a contempt citation.

At present, there is a race to decide whether a decision by the Tenth Circuit or Seventh Circuit will arrive first in the Supreme Court. In Chicago, some but not all bankruptcy judges have held that the city must automatically turn over automobiles that were impounded before bankruptcy on account of unpaid parking fines. The Seventh Circuit accepted a direct, consolidated appeal. The last brief is due in the Seventh Circuit on December 31. Consequently, the trustee in *Garcia* may end up filing the first *certiorari* petition.

To read some of ABI's coverage of *Cowen*, *Garcia*, and the Chicago cases, click here, here, here, here, and here.

Opinion Link

PREVIEW

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Case Details

Judge Name	Robert E. Nugent
Case Citation	Davis v. Tyson Prepared Foods Inc. (In re Garcia), 17-3247 (10th Cir. Oct. 17, 2018)
Case Name	In re Garcia
Case Type	Business
Court	10th Circuit
Bankruptcy Tags	Automatic Stay Claims Bankruptcy Litigation Practice and Procedure Consumer Bankruptcy Business Reorganization Labor/Employment

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ABI EXCLUSIVE

September 12, 2018

Major Automatic Stay Issue Inches Toward the Supreme Court

> Chicago parking ticket cases to be resolved in the Seventh Circuit.

The protracted battle over parking fines between the City of Chicago and chapter 13 debtors may draw to a conclusion next year, unless the Supreme Court takes an interest in the question. If the Supreme Court weighs in, the high court could use parking tickets to decide whether the automatic stay is automatic after all.

In three consolidated, direct appeals to the Seventh Circuit, bankruptcy judges in Chicago had concluded that the city must turn over an impounded car automatically when the owner files a chapter 13 petition. The appeals court entered a scheduling order calling for the last brief to be filed on November 19.

Fiscally speaking, the issue is important for Chicago. Bankruptcy Judge Deborah L. Thorne said that Chicago relies on parking fines and red-light tickets for 7% of its budget. According to the most recent decision by Bankruptcy Judge Carol A. Doyle of Chicago, the fines generate $260 million for the city annually.

In substance, the question is whether the automatic stay in Section 362 requires the city to turn over impounded cars automatically. The city is fighting an uphill battle because Seventh Circuit law favors debtors.

In *Thompson v. General Motors Acceptance Corp.,* 566 F.3d 699 (7th Cir. 2009), the Seventh Circuit ruled that passively holding an asset is an act to "exercise control" that violates the automatic stay under Section 362(a)(3). The appeals court held that a lender must return an auto it had repossessed. After return, the lender may seek adequate protection.

Brandishing *Thompson*, Chicago residents who lost their cars could file chapter 13 petitions to regain possession of their vehicles, even if they have no intention of confirming their chapter 13 plans. Hoping to avoid *Thompson*, Chicago adopted legislation specifically giving the city a possessory lien against vehicles that were impounded as a result of unpaid fines.

Among other things, the city argues that the possessory lien invokes the exception to the automatic stay in Section 362(b)(3). That section makes the stay inapplicable to "any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) . . . ." The city believes that retaining possession is a means for maintaining perfection and is thus excepted from the automatic stay.

In August, Bankruptcy Judge Thorne dissected and rejected the Section 362(b)(3) theory in *In re Peake*, 18-16544, 2018 BL 292576 (Bankr. N.D. Ill. Aug. 16, 2018). *Peake* is one of the cases on direct appeal to the Seventh Circuit. To read ABI's discussion of *Peake*, click here.

In the newest decision on September 7, Judge Doyle analyzed and rejected a plethora of arguments by the city, including a contention that *Thompson* was wrongly decided.

Judge Doyle provided an especially detailed analysis of Section 362(b)(3). She dismissed Chicago's theories, concluding that "the City cannot shoehorn itself into any provision of Section 546(b) to qualify for Section 362(b)(3), an exception intended only to let parties preserve their lien rights in bankruptcy, not to retain possession of the debtor's property."

Judge Doyle found nothing special in Chicago's statutory lien rights. She said "the City is really contending that possessory lien holders get better treatment in bankruptcy than other lien holders. Not so . . . . [A]ll secured creditors in a chapter 13 case are entitled to the same treatment."

Having concluded that the exception to the automatic stay did not apply, Judge Doyle said that the city's refusal to return the car on request "violated at least three provisions in the automatic stay — § 362(a)(3), § 362(a)(4), and § 362(a)(6) — and the dictates of *Thompson*."

Chicago has not been without victories. In May, a district judge reversed the bankruptcy court and validated the city's theories under Section 362(b)(3). *City of Chicago v. Kennedy*, 17-5945, 2018 BL 159358, 2018 WL 2087453 (N.D. Ill. May 4, 2018).

The Circuit Split

Even if Chicago loses in the Seventh Circuit, the city could file an attractive petition for *certiorari*, because two circuits disagree with *Thompson*. *See, e.g., WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017), where the Tenth Circuit held that passively holding an asset of the estate, in the face of a demand for turnover, does not violate the automatic stay in Section 362(a)(3) as an act to "exercise control over property of the estate." The District of Columbia Circuit holds the same opinion.

The Second, Ninth and Eighth Circuits are in accord with *Thompson* and hold that retaining property after demand for turnover does violate the automatic stay.

The Supreme Court might use parking tickets as the vehicle for resolving the widening circuit split, but someone else might beat Chicago to the punch.

Although there was no *certiorari* petition in *Cowen*, the same underlying issue is on direct appeal to the Tenth Circuit from *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, 17-5006, 2017 BL 235622 (Bankr. D. Kan. July 7, 2017), where Bankruptcy Judge Robert E. Nugent of Wichita, Kan., was forced to rule, contrary to two prior decisions of his own, that the automatic stay did not prevent a statutory worker's compensation lien from attaching automatically after bankruptcy to a recovery in a lawsuit.

Because the issues in *Garcia* and *Cowen* are so similar, the *Garcia* appeal is likely to be a precursor to a motion for rehearing *en banc* or a *certiorari* petition to resolve the circuit split. Whether Chicago or *Garcia* is the launching pad, the split over the automatic stay is an issue the Supreme Court should tackle in the next couple of terms.

For ABI's discussion of *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, 17-3247 (10th Cir.), click here. The appeal is scheduled for oral argument on September 26.

Opinion Link

PREVIEW

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Case Details

Judge Name	Carol A. Doyle
Case Citation	In re Shannon, 18-4116 (Bankr. N.D. Ill. Sept. 7, 2018)
Case Name	In re Shannon
Case Type	Circuit Splits

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Court	7th Circuit Illinois Illinois Northern District
Bankruptcy Tags	Automatic Stay Practice and Procedure Consumer Bankruptcy Business Reorganization

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An insightful writer known for his authoritative take on legal developments affecting bankruptcy practice, Bill Rochelle published for Bloomberg every day from 2007 through 2015.

Prior to his second career in journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP.

By The Numbers

Total cases in system	1026
Business Cases	389
Consumer Cases	446
Circuit Splits Cases	43
Supreme Court Cases	58
Total Judges	583

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Rochelle's Daily Wire
ABI EXCLUSIVE

February 22, 2018

Consumer Protection Claims by Governments Are Discharged in Chapter 11

> Consumer protection claims brought by states are nondischargeable in chapter 11 only when the state has been the target of fraudulent representations.

In a chapter 11 corporate reorganization, the debt arising from violation of state consumer protection laws is nondischargeable only when the state is defrauded, not when consumers are defrauded, according to Bankruptcy Judge Brendan L. Shannon of Delaware.

Judge Shannon's Feb. 14 opinion represents a second proposition: Creditors are unlikely to win a lawsuit that would blow up confirmation of a large, heavily negotiated chapter 11 plan.

The dischargeability dispute arose in the reorganization of subsidiaries of Takata Corp. that manufactured defective airbags, resulting in the largest recall in U.S. history. Prior to bankruptcy, two states and the U.S. Virgin Islands sued Takata for making false statements and violating state consumer protection laws.

The debtors sued in bankruptcy court for a declaration that any damages in the suits would be dischargeable.

In an individual's bankruptcy, 19 types of debts are excepted from discharge under Section 523(a). For a corporate debtor in chapter 11, only debts of the type in Section 523(a)(2)(A) or (a)(2)(B) can be excepted from discharge under Section 1141(d)(6). Those subsections relate to fraud or fraudulent representation.

Section 1141(d)(6) includes an additional requirement that a nondischargeable debt must be owing to a "domestic governmental unit."

The debtors argued that the debts were not owed to the states because the claims were for damages to consumers. Judge Shannon disagreed.

He said that the state laws gave the states standing to sue on behalf of their citizens. Nonetheless, he said, "judgments would constitute obligations owed to the states" and therefore would be "owed to a domestic governmental unit."

The debtors prevailed on the second issue dealing with fraudulent representation. Judge Shannon said that the Supreme Court "has strictly construed Section 523(a)(2)" to require proof that the fraudulent representation was "made by a debtor to the affected creditor and that the creditor must have [justifiably] relied."

In the Takata case, Judge Shannon said there was no allegation that the states received or relied on the debtors' representations.

Summing up, Judge Shannon said "there is no question" that corporate debtors "may obtain a discharge from claims of individuals for the precise conduct that forms the basis" for the state's claims. Similarly, Judge Shannon ruled that the debtors are entitled to discharge the states' claims because "Congress has precluded a discharge" only when "the governmental unit is the actual victim of a corporate debtor's fraudulent conduct or representations."

Judge Shannon "buttressed" his conclusion by reference to Section 523(a)(7), where a debt owing by an individual to the government for a fine, penalty or forfeiture owing is nondischargeable. Congress did not include (a)(7) in the types of debts that are nondischargeable in chapter 11.

Given that the conduct alleged by the states "fall[s] squarely" under (a)(7), Judge Shannon said that civil fines and penalties unrelated to a governmental unit's "own actual losses" are discharged in chapter 11.

The states appealed immediately, but the appeal may become moot if the states do not obtain a stay of Takata's impending confirmation order pending appeal.

In district court, the states might try an argument based on *Husky International Electronics Inc. v. Ritz*, 136 S. Ct. 1581, 194 L. Ed. 2d 655, 84 U.S.L.W. 4270 (2016), where the Supreme Court held that a debt can be nondischargeable under Section 523(a)(2)(A) even if the debtor made no misrepresentation to the creditor.

Arguably, *Husky* undercuts the debtors' contention that the misrepresentation must be aimed at the states. It is possible, however, that *Husky*, a controversial decision, will be limited to cases under Section 523(a)(2)(A) involving nondischargeable debts owing by individuals. In addition, the states may not be able to rely on *Husky* if the argument was not raised in bankruptcy court.

Opinion Link

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Case Details

Judge Name	Brendan L. Shannon
Case Citation	TK Holdings Inc. v. Hawaii (In re TK Holdings Inc.), 17-51886 (Bankr. D. Del. Feb. 14, 2018)
Case Name	In re TK Holdings Inc.
Case Type	Business
Court	3rd Circuit Delaware
Bankruptcy Tags	Claims Discharge/Dischargeability Business Reorganization

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