

Alexander L. Paskay Memorial Bankruptcy Seminar

Judicial Roundtable Workouts: Problems, Problems, Problems!

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BENCH BRIEF

Problem 1: Counting in Bankruptcy is Never as Easy as 1, 2, 3

Lucky Lemons, LLC ("**Debtor**") had for years operated ten bars profitably in the Tampa Bay area. However, the COVID-19 pandemic decimated the Debtor's business operations and, coupled with the investment of local businessmen and government in developing the Water Street area, rather than the districts where the Debtor's operations were concentrated, the Debtor's sales dwindled. The Debtor rented its premises from multiple landlords. As of petition date, the Debtor was involved in litigation with Party Parking Management, Inc. ("Party"), arising from the Debtor's failure to remit the net parking revenues to Party. Historically, the Debtor had collected parking revenue, paid certain authorized expenses, paid itself a management fee, and then paid the net revenue to Party. The Debtor was also named as a defendant in litigation arising from a stabbing that occurred on the premises, and the Debtor's liability insurance covered the defense.

The Debtor ceased operations as of December 31, 2023, but maintained its bank account, and, on January 3, 2024, decided to seek relief under the Bankruptcy Code and elected to proceed under subchapter V of chapter 11. Shortly after the petition date, the Debtor moved to reject the leases, effective as of the petition date. The Debtor's schedules did not list the lease rejection claims but listed other claims totaling \$7,000,000.00. The landlords filed rejection damage claims in the aggregate of \$1,000,000.00.

Questions for Discussion

1. Is the Debtor engaged in commercial or business activities within the meaning of section 1182(1)(A) such that the debtor is eligible to proceed as a subchapter V debtor?

Analysis: Section 1182(1)(A) of the Bankruptcy Code provides that "[a] person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and exclusion a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order of relief in an amount not more than \$7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor:...¹

¹ 11 U.S.C. § 1182(1)(A).

The Bankruptcy Code does not define the terms "engaged" or "commercial or business activities." However, looking to the common meaning of those words, "engaged" means "involved in activity: occupied, busy." "Commercial or business activities" refers to work intended for commerce or with a profit motive or transactions of an economic nature.

The Debtor bears the burden of proving eligibility for subchapter V.⁵ From a practical standpoint, it makes sense for the debtor to carry the burden of proof "because debtors are in the best position to prove that they are qualified to be in subchapter V."⁶

In the *Vertical Mac* case, the debtor ceased operations about six months before the petition date, was not actively collecting accounts receivable, was not pursuing lawsuits against third parties, and did not intend to resume operations. However, the debtor maintained a bank account, had accounts receivable, was engaged with insurance adjusters and insurance defense counsel to resolve various claims, and was preparing for a sale of its assets. Judge Vaughan embraced a broad and interpretation of the phrase "engaged in commercial or business activities," holding that the plain meaning of the phrase incorporates a "very inclusive range of commercial or business activities." By maintaining bank accounts, working with insurance adjusters and insurance defense counsel to resolve the claims, and preparing for the sale of its assets, Judge Vaughn concluded the debtor was engaged in commercial or business activities.

In *Thurmon*, former business owners sought relief under subchapter V.¹⁰ While their debts were primarily business debts and derived from the operation of their business, the business was no longer operating as of the petition date and the assets of the business were sold, with the exception of some outstanding accounts receivable and two cars.¹¹ The business entity was still in good standing under Missouri law.¹² Judge Norton found that the debtors were not eligible to proceed under subchapter V because they were not "engaged in commercial or business activities."¹³ However, under the very unique circumstances of the case, the court did not require the debtors to file a disclosure statement and confirmed the debtors' consensual plan under section 1129 (although the debtors were required to pay quarterly fees to the United States Trustee as of the effective date of the order).

²In re Vertical Mac Constr., LLC, No. 6:21-BK-01520-LVV, 2021 WL 3668037, at *2 (Bankr. M.D. Fla. July 23, 2021).

³ *Id*.

⁴ *Id.* at 3.

⁵ *Id.*; but see In re Body Transit, Inc., 613 B.R. 400, 409 n. 15 (Bankr. E.D. Pa 2020). (one of the few cases concluding that the objecting party has the burden of proof to establish ineligibility).

⁶ NetJets Aviation, Inc. v. RS Air, LLC (In re RS Air, LLC), 638 B.R. 403, 414 (B.A.P. 9th Cir. 2022).

⁷ In re Vertical Mac Construction, LLC, 2021 WL 3668037, at *3.

⁸ Id. at 3; see also In re Ellingsworth Residential Cmty. Ass'n, Inc., 619 B.R. 519, 521 (Bankr. M.D. Fla. 2020); In re Offer Space, LLC, 629 B.R. 299 (Bankr. D. Utah 2021); In re Ikalowych, 629 B.R. 261 (Bankr. D. Colo. 2021).

⁹ In re Vertical Mac Constr., LLC, 2021 WL 3668037, at *4..

¹⁰ In re Thurmon, 625 B.R. 417 (Bankr. W.D. Mo. 2020) (Norton, J.).

¹¹ Id. at 419.

¹² Id. at 423.

¹³ *Id*.

Conclusion: In the problem, Lucky has ceased operations as of the petition date, but maintains a bank account and is involved in a dispute with Party and the premises liability suit. Under the teachings of *Vertical Mac*, Lucky is likely eligible to proceed under subchapter V and is "engaged in commercial or business activities." However, *Thurmon* could militate in favor of a different result, but not necessarily.

If the subchapter V designation is revoked, and the case continues as a traditional chapter 11 case, query whether exclusivity is still in place if more than 120 days have elapsed since the petition date. This could be a significant issue, as only the debtor may propose a plan in subchapter V. Also, if the election is revoked, do quarterly fees accrue retroactive to the petition date or is *Thurmon*'s guidance helpful?

2. Are the claims with Party noncontingent and liquidated such that they count towards the subchapter V debt cap?

Analysis: Pursuant to section 1182(1)(A) of the Bankruptcy Code, to be eligible to proceed under subchapter V, a debtor must have aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order of relief in an amount not more than \$7,500,000.

A debt that is liquidated if it can be calculated—"the concept of a liquidated debt relates to the amount of liability, not the existence of liability."¹⁴ However, a "substantial dispute" over the allowance of a creditor's claim does not render the claim unliquidated for the purposes of determining eligibility.¹⁵ Indeed, debts of a contractual nature are typically considered liquidated, even if disputed.¹⁶

A debt is noncontingent if "all events necessary to give rise to liability take place prior to filing the petition." ¹⁷

Conclusion: Applying *Hall*, Party's debt likely counts towards the debt limit, as even though it is disputed, is liquidated and noncontingent, since it arises from a contract.

3. Are the lease rejection claims noncontingent and liquidated such that they count towards the subchapter V debt cap?

Analysis: Pursuant to section 1182(1)(A) of the Bankruptcy Code, to be eligible to proceed under subchapter V, a debtor must have aggregate noncontingent liquidated secured and

¹⁴ United States v. Verdunn, 89 F.3d 799, 802 (11th Cir. 1996).

¹⁵ In re Hall, 650 B.R. 595 (Bankr. M.D. Fla. 2023) (Burgess, J.).

¹⁶ Id. at 599 (citing Barcal v. Laughlin (In re Barcal), 213 B.R. 1008, 1014 (B.A.P. 8th Cir. 1997)).

¹⁷ In re Green, 574 B.R. 570, 576–77 (Bankr. E.D.N.C. 2017).

unsecured debts as of the date of the filing of the petition or the date of the order of relief in an amount not more than \$7,500,000.¹⁸

The bankruptcy court in *Parking Management* was one of the first courts to address whether claims for future rent arising from rejection damage claims should count towards the subchapter V debt cap.¹⁹ In *Parking Management*, the debtor filed motions to reject leases after the petition date but rejected five of the twelve leases rejected effective as of the petition date.²⁰ The debtor did not list the rejection damages claims on its schedules and took the position that the claims were contingent as of the petition date.²¹ In ruling that the lease rejection claims were contingent as of the petition date, the court held that the claims were contingent until the court approved the rejections.²² The court also noted that "[t]he majority of courts that have considered the effect of a postpetition event on eligibility to file (or be converted) to Chapter 13 have concluded that postpetition events should not be considered in determining eligibility."²³

However, the *Macedon Consulting* court reached a different conclusion.²⁴ In that case, the landlord took the position that the debtor was ineligible for subchapter V because the future payments that the debtor owed under the lease exceed \$7,500,000. The debtor moved on the petition date to reject its unexpired office leases. The bankruptcy court concluded that the debtor's future rent obligations were noncontingent on the basis that the debtor's liability for all rent over the term of the leases arose prepetition, on the dates the leases were fully executed.²⁵

However, the bankruptcy court in *Zhang Medical P.C.* expressly rejected the ruling in *Macedon Consulting*, concluding that "a debtor's future payment obligations under its unexpired leases and executory contracts should rarely, if ever, be counted toward the subchapter V debt cap." While the *Zhang* court concluded that the debtor was ineligible for subchapter V because scheduled and filed claims exceeded the debt cap without deciding whether claims for future rent should count towards the cap, the court addressed the issue "because of the enormous—and in the Court's view detrimental—impact that ruling, if followed, would have in limiting eligibility for subchapter V relief," as many debtors are party to long-term leases or contracts with significant future payment obligations, which, if counted towards the cap would deny such debtors access to relief under subchapter V.²⁷ Unlike the debtor in Macedon Consulting, the debtor spent the first few months of the case attempting to negotiate with the landlord before seeking to reject the lease.²⁸

¹⁸ 11 U.S.C. § 1182(1)(A).

¹⁹ In re Parking Mgmt., Inc., 620 B.R. 544 (Bankr. D. Md. 2020).

²⁰ *Id.* at 552.

²¹ *Id*.

²² Id. at 555.

²³ *Id.* at 554.

²⁴ In re Macedon Consulting, Inc., 652 B.R. 480, 485–86 (Bankr. E.D. Va. 2023).

²⁵ Id. at 485

²⁶ In re Zhang Med. P.C., 655 B.R. 403, 407 (Bankr. S.D.N.Y. 2023).

²⁷ *Id*.

²⁸ *Id.* at 413.

Conclusion: Neither *Macedon Consulting* nor *Zhang Medical* are binding in this jurisdiction and are merely persuasive. There is certainly an argument that the facts of this case are more like *Zhang Medical* because the debtor moved to reject the leases after the petition date, but is the relevant question when the debtor seeks rejection of the lease?²⁹ Is it enough for the debtor to wait a few days to file a motion to reject to circumvent *Macedon*? In some ways, it seems to elevate form over substance, and this question is intended to focus on the practical and policy considerations of the *Macedon Consulting* decision.

4. If the Debtor is able to proceed in subchapter V, and none of the unsecured creditors vote for the plan, can the plan be confirmed consensually under section 1191(a) of the Bankruptcy Code?

Analysis: Several bankruptcy courts have recently ruled that a nonvoting impaired creditor class should not be counted for purposes of determining acceptance of subchapter V plans. Unsurprisingly, the decisions do not engage in much analysis of the Bankruptcy Code and are rooted in practical and policy considerations. As explained by Judge Jones, "[f]rom a practical perspective, a creditor that agrees to a debtor's plan may express its consent by affirmatively voting for a plan or by simply choosing not to file an objection. The outcome should be no different, as the overarching policy of Subchapter V is satisfied."³²

Conclusion: While the Eleventh Circuit has not ruled on the issue, the debtor could certainly argue that the plan could be confirmed consensually. But is it to the debtor's advantage to confirm under section 1191(a)? While the debtor receives a discharge on confirmation and the subchapter V trustee is discharged as of the effective date, the debtor loses the ability to modify its plan if confirmed under section 1191(a).

Another question—will these subchapter V cases have any impact on determining class acceptances of a plan in a traditional chapter 11 cases?

²⁹ See discussion at *In re Zhang Medical P.C.*, 655 B.R. at 412, n.8. Even though the debtor moved to reject its leases on the petition date, the Macedon court did not base its decision on this fact—"[c]uriously, the court did not hold that the debtor's petition-date motion made its rejection damages liability noncontingent by eliminating any uncertainty as to whether it would reject. Instead, the court treated the debtor's rejection as a contingent post-petition event that it should not consider." *Id.*

³⁰ In re Hot'z Power Wash, Inc., 655 B.R. 107 (Bankr. S.D. Tex. 2023); In re Franco's Paving LLC, 654 B.R. 107 (Bankr. S.D. Tex. 2023).

³¹ In re Franco's Paving LLC, 654 B.R. at 110.

³² *Id*.

Problem 2: Bad Boys

Barbie and Ken decided to redecorate the Mojo Dojo Casa House, to make the home more suitable for resale. Ken, to assert his continued dominance, oversaw the contractors and supervised the renovations from horseback in his faux fur shrug. Barbie was blissfully unaware of any details concerning the remodel, as she was concerned with the Real World. After the renovations were completed, Barbie and Ken sold the house. Ken managed the written disclosures, as Barbie had no knowledge of the renovations or the condition of the renovated home, since she was spending so much time in the Real World. The Buyers sued Ken and Barbie, alleging the failure to disclose known defects in the home and prevailed, resulting in a \$1,000,000.00 judgment being entered against Barbie and Ken. Barbie and Ken filed a voluntary petition for relief, seeking relief under chapter 7 of the Bankruptcy Code. The Buyers sought to have the debt determined to be non-dischargeable as to Barbie and Ken.

In the dischargeability litigation, discovery disputes ensued, and one of the contractors refused to turn over documents responsive to the subpoena duces tecum, taking the position that he was from the Real World, not Barbie Land/Kendom, and the bankruptcy court had no jurisdiction over him. Prior to filing a motion to compel, counsel for the Buyers contacted the Contractor's counsel to confer, but counsel for the Contractor declined to respond. The Buyers served the motion to compel on counsel for the Contractor. The Contractor took the position that the bankruptcy court did not have jurisdiction over him individually, as his LLC had provided the services to Ken and Barbie, and that the Buyers would need to serve him in accordance with the Hague Convention. The bankruptcy court entered an order granting the motion to compel, but the Contractor refused to comply. The bankruptcy court entered a contempt order against the Contractor but stayed any decision with respect to sanctions to allow the contractor to appeal to address the jurisdictional issues. Fourteen days passed from the entry of the contempt order, and the Contractor did not file a notice of appeal. The bankruptcy court entered an order awarding monetary sanctions against the contractor. The Contractor appealed the sanctions award.

The bankruptcy court determined the debt was non-dischargeable as to Barbie, even though the evidence showed she neither knew nor should have known Ken's disclosures were fraudulent.

Questions for Discussion

1. Did the bankruptcy court properly determine that the buyer's debt is non-dischargeable as to Barbie? Could Barbie and Ken structure the investment/sale transaction to shield Barbie from liability? If so, how?

Analysis: A year ago, these facts may have resulted in a different outcome for Barbie in the Second, Fourth, Seventh, or Eighth Circuits (although not in the Fifth, Sixth, Ninth, or Eleventh Circuits).³³ On February 22, 2023, the Supreme Court rendered a

³³ While the position of the Fifth, Sixth, and Ninth Circuits on the circuit split is clear, the Eleventh Circuit's position is somewhat more amorphous. In the *Bilzerian* case, the Eleventh Circuit adopted the "receipt of benefits" theory favored by the Fifth, Sixth, and Ninth Circuits, but did not necessarily reach the issue of whether the fraud of one individual could be imputed to another who had no knowledge of the fraud simply because they received a benefit, as the Court concluded Bilzerian actively participated in the fraud. *HSSM # 7 Ltd. P'ship v. Bilzerian (In re Bilzerian)*, 100 F.3d 886, 890-91 (11th Cir. 1996). The Eleventh Circuit's seeming equivocation is perhaps evident from the

unanimous opinion holding that the debtor wife could not discharge her liability for a debt arising fraudulent misrepresentations made by the debtor husband to the buyer of a home remodeled by the debtors, regardless of the wife's culpability to resolve the circuit split.³⁴ The Bartenwerfers remodeled a home they jointly purchased in San Francisco. David oversaw the project, and he hired contractors, monitored and reviewed their work, and signed checks.³⁵ Kate was uninvolved. In connection with the sale of the home to Kieran Buckley, the Barternwerfers both attested that they had disclosed all material facts relating to the property. Thereafter, Buckley discovered several undisclosed defects in the property and brought suit in California state court. He ultimately prevailed on his claims for breach of contract, negligence, and nondisclosure of material facts, and a jury awarded him in excess of \$200,000 in damages.³⁶

Justice Barrett delivered the opinion of the Court, and her analysis was based on a textualist approach, as is typical of the current Court. Section 523(a)(2)(A) is written in the passive voice, and, therefore, the relevant inquiry focuses on how the money was obtained, not who committed fraud to obtain it—"[p]assive voice pulls the actor off the stage."³⁷

However, Justice Sotomayor's concurrence may open the door to limiting the holding of Bartenwerfer. Justice Sotomayor noted that "[t]he Court here does not confront a situation involving fraud by a person no agency or partnership relationship to the debtor," and "[i]nstead, '[t]he relevant legal context' concerns fraud only by 'agents' and 'partners within the scope of the partnership." It was with that understanding that Justice Sotomayor joined the Court's opinion.

Conclusion: The facts of this hypothetical are on all fours with *Bartenwerfer*. The bankruptcy court properly denied Barbie her discharge, even though she may have had no culpability for the fraud Ken committed. While the outcome of *Bartenwerfer* may seem draconian and harsh, if David and Kate had formed a corporation or LLC and transferred the house to the entity prior to sale, Kate could have been shielded from Buckley's claim and her loss would have been limited to her investment.

2. What are the implications of an individual being subject to liability for the fraud of another, where the individual has no act, omission, intent or knowledge of his or her own, particularly in other contexts where vicarious liability is an issue?

Analysis: During oral argument, Justice Thomas offered a hypothetical involving an infant child as a partner—would the debt for fraud be nondischargeable as to an infant?

Court's acknowledgement of the contradictory holdings rendered by the Fifth Circuit in *Luce* and *Allison*. *Id*. (citing *Luce v. First Equip. Leasing Corp. (In re Luce)*, 960 F.2d 1277 (5th Cir. 1992); *but see Allison v. Roberts (In re Allison)*, 960 F.2d 481, 486 (5th Cir. 1992) (declined to impute the fraudulent acts of one spouse to an innocent spouse)).

³⁴ Bartenwerfer v. Buckley, 598 U.S. 69, 143 S. Ct. 665, 214 L. Ed. 2d 434 (2023).

^{35 598} U.S. at 72-73.

³⁶ I.A

³⁷ 598 U.S. at 75-76.

³⁸ *Id.* at 84.

Justice Sotomayor inquired as to whether a debt would be nondischargeable as to the transferee, where the loan was obtained fraudulently, but the borrower transferred the debt to someone not aware of the fraud.

Despite the debtor's arguments that state law governs vicarious liability but does not determine dischargeability, Justice Barrett bolstered her textual analysis by examining the common law of fraud, comparing Kate's liability for David's actions to situations where principals are the frauds of their agents or where individuals are held liable for fraud committed by the partners within the scope of the partnership. Thus, the "agnosticism" created by the use of passive voice in section 523(a)(2)(A) is consistent with the common law principle that individuals can be found liable for fraudulent schemes they did not devise.

The *Bartenwerfer* decision may also impact cases involving violation of securities law. Prior to *Bartenwerfer*, Judge Russin held that for a debt for the violation of securities law to be nondischargeable under section 523(a)(19), the debtor must have been a party in the lawsuit resulting in the finding of a violation of securities law.³⁹ However, the result may now be different under section 523(a)(2)(A), to the extent that the debtor is vicariously liable for a securities violation, even if the debtor is without fault.

Conclusion/Discussion: Hopefully, the question inspires discussion about the overarching implications of the *Bartenwerfer* decision.

3. Should the chapter 7 case be dismissed as a bad faith filing under section 707(a) of the Bankruptcy Code as to Barbie, Ken, or both?

Analysis: Under Section 707(a), "The court may dismiss a case under this chapter only after notice and a hearing and only for cause "40 While "for cause" is not defined, in *In re Piazza*, the Eleventh Circuit held "the ordinary meaning of 'for cause' is adequate or sufficient reason," including "a finding that the debtor's petition was filed in bad faith."41 In turn, "a totality-of-the-circumstances approach is the correct legal standard for determining bad faith under § 707(a). The totality-of- the-circumstances inquiry looks for atypical conduct that falls short of the honest and forthright invocation of the Bankruptcy Code's protections."42

In *Piazza*, the Eleventh Circuit endorsed a multi-pronged inquiry to determine whether the totality of the circumstances of a bankruptcy filing reveals bad faith, including consideration of—

(a) a debtor's intent to abuse the judicial process,

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³⁹ Nationwide Judgment Recovery, Inc. v. Reefe (In re Reefe), 638 B.R. 834 (Bankr. S.D. Fla. 2022).

⁴⁰ 11 U.S.C. § 707(a).

⁴¹ In re Piazza, 719 F.3d 1253, 1271 (11th Cir. 2013).

⁴² *Id.* (cleaned up).

- (b) a debtor's intentional efforts to delay or frustrate legitimate creditors,
- a debtor deliberately racking up debts he has no ability to repay and then (c) seeking to shield himself from creditors through bankruptcy,
- a debtor having non-economic motives, including to frustrate a divorce (d) court decree or force an ex-spouse into bankruptcy,
- a debtor using bankruptcy as a refuge from another court's jurisdiction, (e)
- a debtor making every effort to avoid payment of an obligation despite (f) being capable of at least partial repayment,
- a debtor having primarily a single creditor, (g)
- a debtor's failure to make significant lifestyle adjustments or efforts to (h) repay, and
- a disproportionate debt-to-income ratio in the absence of a marked (i) calamity or sudden loss of income.⁴³

Even so, this is not just a simple mathematical or check-the-box inquiry. Instead, the court must "sift the circumstances surrounding" a case to determine whether the debtor has "abused the provisions, purpose, or spirit of bankruptcy law."⁴⁴

Conclusion: Both Barbie and Ken are at risk of having their case dismissed, as a number of the *Piazza* factors would apply, but a number of factors are not directly addressed by the hypothetical and leave the door open for robust argument.

4. What efforts should counsel make to confer with respect to discovery disputes? What are required by the local rules of your court?

Analysis: In the Middle District of Florida, Local Rule 7026-1 requires that all "[m]otions to compel and motions for protective orders [] include a certification that the movant has in good faith conferred with the opposing party in an effort to resolve the issue without Court action."

The Local Rules for the District Court for the Middle District of Florida include more express conferral requirements. Local Rule 3.01(g) provides that any motion must include a "Local Rule 3.01(g) Certification" certifying (i) whether the movant conferred with the opposing party, (ii) whether the parties agree on the resolution of all or part of the motion, and (iii) if the motion is opposed, explain the means by which the conference occurred."

Conclusion/Discussion: This has been an issue of much debate at local bar CLEs and judicial liaison meetings. Is an email sufficient to satisfy the conferral requirement of the

⁴³ *Id.* at 1271, n.7.

⁴⁴ *Id.* at 1272 (quoting *In re Tamecki*, 229 F.3d 205, 207 (3d Cir. 2000)).

current Local Rule 7026-1? A telephone call? What is the most effective way to resolve discovery disputes without court intervention?

5. Was service of the motion for contempt on counsel for the contractor sufficient to gain jurisdiction over the contractor?

Analysis: For purposes of the analysis, the contractor should be treated as a foreign national abroad, since he is from the Real World and not Barbie World/Kendom.

In one of his final decisions, Judge Williamson addressed complex international service issues. 45 In the *Procom* case, a Hungarian national took the position that the chapter 7 trustee's service of a subpoena on his counsel was insufficient service of process and that he must be served in accordance with the Hague Convention. In concluding that service on the Hungarian national's counsel was proper service, Judge Williamson first noted that the Supreme Court rejected the Hague Convention was not the exclusive or primary means of obtaining discovery from a foreign national abroad; rather, whether a party must resort to the Hague Convention is governed by principles of international comity.⁴⁶ Hungarian national did not show that international comity required the trustee to bypass the Federal Rules of Civil Procedure and serve the subpoena in accordance with the Hague Convention, as the foreign national had extensive business connections to the United States, the trustee alleged that the his company owed millions to creditors in the United States, and the trustee had issued the subpoena to further his efforts to administer the estate. Judge Williamson further found that service of the subpoena on counsel for Hungarian national was sufficient under Federal Rule of Civil Procedure 45, as substitute service is permissible, as long as the substitute service is reasonably calculated to ensure the subpoena reaches the named person.⁴⁷ However, there is a split of authority as to whether substitute service is permitted under Rule 45, and while the Eleventh Circuit has not ruled on the issue, the emerging trend in Florida district courts is to permit substitute service, so long as it is reasonably calculated to ensure receipt of the subpoena by the witness. 48

Conclusion: The first issue is whether international comity requires the buyers to serve the subpoena on the contractor in accordance with the Hague Convention. The contractor will argue that the international comity requires service in accordance with the Hague Convention because he is a foreign national and does not have sufficient connection to Barbie World or the case, nor was the subpoena served by a trustee tasked with the fiduciary obligation to administer the bankruptcy estate. The buyers will argue that the contractor has done business in Barbie World for years.

The second issue is whether substitute service may be accomplished under Rule 45. As the Eleventh Circuit has not ruled on the issue, this remains an open issue, although given

⁴⁵ In re Procom Am., LLC, 638 B.R. 634 (Bankr. M.D. Fla. 2022).

⁴⁶ *Id.* at 637–38 (citing *Societe Nationale Industrielle Aerospatiale v. U.S. Dist. Ct. for S. Dist. of Iowa*, 482 U.S. 522, 529, 541–42, 107 S. Ct. 2542, 96 L. Ed. 2d 461 (1987)).

⁴⁷ *Id.* at 638.

⁴⁸ *Id.* at 640, n. 23–25.

the recent trends in Florida federal courts, substitute service on the contractor's counsel was likely adequate under Rule 45.

6. Does the district court have jurisdiction over the contractor's appeal of the sanctions award?

Analysis: The Eleventh Circuit's recent decision in *Asset Enhancement, Inc.* is instructive. An appeal of the bankruptcy court's contempt order arising from damages for violation of the automatic stay was timely even though the appeal was taken more than fourteen days after the order was entered. The contempt order awarded reasonable attorneys' fees and costs for the filing and prosecution of the contempt motion but did not include the amount of the attorneys' fees and costs. The parties stipulated to the amount of attorneys' fees and costs, and the bankruptcy court entered a separate order awarding the attorneys' fees and costs ("Fee Order"). The notice of appeal was filed within fourteen days of the entry of the Fee Order. The debtor moved to dismiss the appeal for lack of jurisdiction as untimely, and the district court dismissed the appeal. Concluding that the appeal was timely filed, the Eleventh Circuit vacated the dismissal of the appeal and remanded to the district court to consider the merits of the appeal.

Conclusion: The contractor's appeal is timely, as the notice of appeal was filed within fourteen days from the entry of the order awarding the monetary sanctions.

⁴⁹ Sweetapple v. Asset Enhancement, Inc. (In re Asset Enhancement, Inc.), 87 F.4th 1271 (11th Cir. 2023).

On the Edge

By Hon. ELIZABETH L. GUNN AND DON MAGO

Eligible or Ineligible Debt? Further Developments in the Definition of the Subchapter V Debt Limitation



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Editor's Note: ABI's Subchapter V Task Force, launched in April, is studying practitioners' experiences with the three-year-old law, culminating in a final report to be released in 2024. Learn more at subvtaskforce.abi.org.

The first wave of cases interpreting subchapter V eligibility addressed whether a company that was in chapter 11 on the law's passage in 2019 was eligible to elect designation after its effective date in February 2020.1 As the enactment date moves further into the past, issues of eligibility have moved instead to more specific questions about the interpretation of § 1182(1)(A) and (B) of the Bankruptcy Code and the definition of a subchapter V "small business debtor."2

Four recent bankruptcy court decisions address three different aspects of the definition: (1) the time frame for calculating total debt based on the postpetition filing of an affiliate debtor; (2) whether certain student loans qualify as business or commercial debt in an individual subchapter V; and (3) how prepetition lease obligations factor into total debt. Each helps to add further color to the understanding of who may be a subchapter V debtor.

Affiliate Filings and Debt Limit: Free Speech Systems and Dobson

Stemming from the saga of radio show host Alex Jones, In re Free Speech Systems addresses the legal impact that affiliate filings have on a sub-

See, e.g., Hon. Hannah L. Blumenstiel, "SBRA: Case Law So Far Suggests an Enthusiastic Bench," XXXIX ABI Journal 6, 24-25, 49-51, June 2020, available at abi.org/ abi-journal (discussing cases with debtors pending before enactment of subchapter V, which sought to make election and positive treatment by bankruptcy courts).

11 U.S.C. § 1182 states:

(1) Debtor. The term "debtor"

(A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than \$7,500,000 (excluding debts owed to [one] or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor; and (B) does not include —

(i) any member of a group of affiliated debtors under this title that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than \$7,500,000 (excluding debt owed to 1 or more affiliates or insiders)

chapter V debtor's eligibility.4 On the petition date, both the debtor and its owner (Jones) had pending damages trials in Texas and Connecticut state courts with the potential for judgments in the multimillions or billions. Early in the case, the bankruptcy court granted relief from the automatic stay to allow the trials to proceed post-petition, resulting in a \$1.5 billion award against the debtor and Jones. Shortly thereafter, Jones filed an individual bankruptcy petition.

The debtor was clearly within the debt limits on the petition date of its case. However, after Jones filed for bankruptcy, the plaintiffs from the state court actions argued that the subchapter V designation should be revoked because Jones's affiliate filing (and thus the \$1.5 billion judgment) caused the debtor to exceed the \$7.5 million eligibility cap. Stated otherwise, the plaintiffs argued that the debtor's eligibility had to be reevaluated on the filing of its affiliate.

The argument focused on the phrase "as of the date of the filing of the petition" in § 1182(1)(A) and its absence in § 1182(a)(B). Therefore, the plaintiffs contended that the language created a continuing obligation during the entirety of a subchapter V case as to the determination of a debtor's eligibility. Thus, if a subchapter V debtor's affiliate files a subchapter V petition while the debtor's case is pending, and such affiliate's debt causes the total debt to exceed the statutory cap, then the original debtor would no longer be eligible to be a subchapter V debtor.

The bankruptcy court disagreed, finding that "[s]ubparagraphs A and B must be construed together at the same time, all the time," and eligibility for a debtor is determined based on the debt as of the petition date, not on an ongoing basis.5 In support of its analysis, the court examined Rule 1020(a)(i) of the Federal Rules of Bankruptcy Procedure, which references Question 8 of the bankruptcy petition.6 Question 8 requires a debtor to elect whether it is eligible for subchapter V in accord with § 1182(1); upon such election, the case proceeds in subchap-

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очесь в то пиоте аппiates of insiders), 3 "Alex Jones," Wikipedia, *available at* en.wikipedia.org/wiki/Alex_Jones (last visited Aug. 7, 2023).

⁴ In re Free Speech Sys. LLC, 649 B.R. 729, 733 (Bankr. S.D. Tex. 2023).

Official Form B 101 Voluntary Petition for Individuals Filing for Bankruptcy and Official Form B 201 Voluntary Petition for Non-Individuals Filing for Bankruptcy.

ter V unless the court orders otherwise. In addition, the court reasoned that the phrase "subject to subparagraph B" in § 1182(1)(A) means that "a debtor must satisfy both prongs on the petition date" before it can elect to be a subchapter V debtor on the petition. Finally, in denying the plaintiffs' motion, the court noted the impracticalities associated with the plaintiffs' argument: "If post-petition affiliate filings lead to ineligibility and revocation, it means that debtors could float in and out of Subchapter V at any time. That contradicts the text and purpose of Subchapter V.

The same challenge to eligibility was raised in the individual subchapter V case of In re Dobson. Tommy and Anne Dobson's eligibility was questioned when a corporation owned by Mr. Dobson filed for chapter 7 the day after the Dobsons filed for bankruptcy; the combined debt of the corporation and the Dobsons themselves exceeded the \$7.5 million cap. Like the plaintiffs in *In re Free Speech* Systems, the U.S. Trustee in Dobson argued that because § 1182(1)(B)(i) did not reference the petition date, the court was required to consider post-petition events when calculating the aggregate affiliate debt under § 1182(1)(B)(i).¹⁰ The court was unpersuaded.

Consistent with In re Free Speech Systems, the Dobson court found that the language of § 1182 does not direct a court to determine eligibility based on post-petition events. Referencing In re Free Speech Systems, the court also noted the impracticalities of allowing eligibility to shift throughout the case, including the potential loss of eligibility because an affiliate obtained post-petition financing.

In addition to the strict statutory argument, the U.S. Trustee in *Dobson* argued that Bankruptcy Rule 1020 tempered the negative effects of shifting eligibility because it provides that an objection to eligibility may be filed until 30 days after the § 341 meeting has concluded or 30 days after the debtor amends its eligibility statement. In dismissing the argument, the court noted that only the U.S. Trustee can conclude the § 341 meeting in a subchapter V case and therefore has exclusive control over the timing to trigger the objection period.12 Further, the deadline for objections under Rule 1020 is not fixed and can be extended under Bankruptcy Rule 9006(b), which therefore could create a "roaming eligibility trap" if the U.S. Trustee's position was accepted.¹³ Dobson and Free Speech Systems appear to settle the issue that the question of whether affiliate debtor liabilities exceed the statutory limit is determined as of a debtor's petition date and is not subject to an ongoing analysis.

"Business Debt" and Individuals: Reis

The In re Reis bankruptcy court faced the question of whether medical school student loan debt qualifies as debt arising from commercial or business activities for an individual doctor debtor's subchapter V eligibility.¹⁴ When Dr. Laura Reis filed a subchapter V case in 2022, she had \$645,869 in medical school debt, of which \$319,028.34 was principal. When faced with a challenge as to her eligibility to be a subchapter V debtor, Dr. Reis argued that her medical school student loans should count as business debts and not as consumer debts.

In considering the question, the bankruptcy court examined the history of the debtor's obligations and found that they had been incurred over a five-year period from 2005-09. After the debtor graduated from medical school in 2009, she completed a three-year residency in Florida and thereafter worked continuously as a non-owner employee for multiple medical agencies. In 2018, the debtor filed for chapter 7 and listed her student loans as primarily consumer debts, but listed her student loans as not primarily consumer debts in her 2022 case. In the interim between her filings, the debtor began to practice under her own limited liability company.

> Given the rapid success and wide adoption of subchapter V, the only clear point is that the question of eligibility will continue to evolve as courts are faced with new factual and legal questions.

While the U.S. Trustee conceded that the debtor was engaged in business activities as of the petition date, it objected to the debtor's eligibility under subchapter V, arguing that (1) § 1182(1)(A) must be interpreted to exclude the subject loans from being characterized as arising from commercial or business activities; and (2) student loans generally are consumer debts. There were two primary interpretation issues presented: (1) whether a majority of Dr. Reis's aggregate noncontingent liquidated debt arose from the commercial or business activity; and, if so, (2) whether such debt must arise from the same commercial or business activities that Dr. Reis was engaged in at the time the petition was filed.

The court noted that there are conflicting opinions on the latter question. However, the Reis court agreed with those courts that have held that the statutory language in § 1182(1)(A) does not require a direct linkage of the commercial or business activities on the petition date and the commercial or business activities from which the debt arose. In addressing the percentage-of-debt issue, the court found that more than 50 percent of the debt was allocated to student loans. Specifically, it found that the student loans were not commercial or business debts, in part because "[t]he Debtor's education had nothing to do with buying, selling, financing, or using goods, rather it gave [the] Debtor the opportunity, as a person, to practice a profession," and found that the debtor was not eligible for subchapter V.15 However, the court made a specific point to note that it was not announcing any sort of per se rule that student loan debt can never qualify as debt arising from commercial or business activities.

15 Id. at *17.

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⁸ Id. at 734 (citing In re Parking Mgmt., 620 B.R. 544, 554 (Bankr. D. Md. 2020)).

⁹ In re Dobson, No. 23-60148, 2023 Bankr. LEXIS 1311, at *7 (Bankr. W.D. Va. May 17, 2023).

¹⁰ Id. at *7. 11 *Id.* at *11.

¹² *Id.* at *13-14. 13 *Id.* at *14.

¹⁴ In re Reis, No. 22-00517, 2023 Bankr. Lexis 1169, at *9 (Bankr. D. Idaho May 2, 2023).

On the Edge: Developments in the Definition of the Sub V Debt Limitation

Noncontingent Liquidated Debt: *Macedon Consulting*

In *In re Macedon Consulting*, the bankruptcy court grappled with whether pre-petition lease obligations for future months are noncontingent and liquidated for purposes of subchapter V eligibility. ¹⁶ Macedon Consulting filed for subchapter V and, on the same day, filed its reorganization plan and a motion to reject certain real property leases. Even though the leases were not terminated pre-petition, the debtor included in its schedules estimated amounts of lease-rejection claims as capped under § 502(b)(6). Thus, the court framed the issue as whether it "should consider the full liability under the leases" or "should allow the estimated lease rejection damages to control" the debt amount included for subchapter V eligibility. ¹⁷

First, the court found that liability under the leases for the entire term of the leases arose pre-petition when they were executed, thus rejecting the argument that the timing of the future rental payments renders the debt contingent. Specifically, the court noted that a future date is certain to occur "[a]bsent the end of the world," making the obliga-

tions under the lease noncontingent and liquidated, therefore they should not be limited to the post-petition § 502(b)(6) cap. Thus, because the debtor's total future obligations under the leases exceeded \$7.5 million, the court found that the debtor was not eligible to be a subchapter V debtor.¹⁹

In reaching its decision, the court distinguished the facts in the case from *In re Parking Management*, one of the first cases to address the issue of unexpired leases on eligibility, which held that pre-petition lease-rejection claims were contingent as of the petition date and therefore not considered in the debt-limitation determination. ²⁰ *Macedon Consulting* creates a clear split in bankruptcy court opinions on how unexpired lease debt factors into subchapter V eligibility.

Conclusion

The case law on the development and refinement of the definition of an eligible small business debtor for subchapter V cases continues to grow. Given the rapid success and wide adoption of subchapter V, the only clear point is that the question of eligibility will continue to evolve as courts are faced with new factual and legal questions.

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 $^{16 \ \}textit{In re Macedon Consulting Inc.}, \ No.\ 23-103000,\ 2023\ Bankr.\ LEXIS\ 1551\ (Bankr.\ E.D.\ Va.\ June\ 14,\ 2023).$ $17\ \textit{Id.}\ at\ ^9.$

¹⁸ Id. at *11.

¹⁹ Interestingly, instead of dismissing the debtor's case, on the debtor's request, the court revoked the subchapter V designation and allowed the debtor to proceed under traditional chapter 11.
20 In re Parking Mgmt., 620 B.R. 544, 554 (Bankr. D. Md. 2020).

Feature

By Michael J. Lichtenstein and Michael L. Bernstein

Eligibility as a Debtor Under SBRA

ubchapter V of chapter 11 was created as part of the Small Business Reorganization Act of 2019 (SBRA) and became effective on Feb. 19, 2020.1 With SBRA, "Congress intended to streamline the reorganization process for small business debtors because small businesses have often struggled to reorganize under chapter 11."2 Subchapter V relief was initially available to debtors with less than \$2.7 million in debts, but that limit has temporarily been increased to \$7.5 million.3 One significant issue is what debts count for purposes of the debt limitation. In a key decision, Hon. Thomas J. Catliota of the U.S. Bankruptcy Court for the District of Maryland recently held that neither leaserejection damages nor Paycheck Protection Program (PPP) funds count against the eligibility cap.

In In re Wright, 4 in denying the U.S. Trustee's motion to strike the debtor's designation as a subchapter V debtor, the court noted that the SBRA was designed to broaden relief available to address small business debt. Thus, "[t]he new Subchapter V ... offers small business debtors a streamlined Chapter 11 procedure that is intended to be less costly and time-consuming than a traditional case. To be eligible for Subchapter V, a debtor⁵ must have 'noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition ... in an amount not more than [the applicable debt ceiling]." Any objection to a debtor's eligibility as a subchapter V debtor must be filed within 30 days after the conclusion of the first meeting of creditors or within 30 days after any amendment to the statement of designation as a subchapter V debtor, whichever occurs later.6

The SBRA was based largely on the recommendations of ABI's Commission to Study the Reform



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of Chapter 11.7 The Commission specifically considered whether chapter 13 precedents were relevant and concluded that they are not, given the different purposes of the two chapters:

Most Commissioners strongly rejected the notion of either a standing trustee for SMEs [small and medium enterprises] or a chapter 13-like process for SME cases. These Commissioners noted that small business cases are not simply big chapter 13 cases. They highlighted the structural differences in business cases, including the debtor's contractual relationships with vendors and suppliers and its obligations to customers. SMEs also have employees to consider and operational issues that may complicate their restructuring alternatives.8

Hon. Michelle M. Harner of the U.S. Bankruptcy Court for the District of Maryland, who prior to taking the bench served as Reporter for the ABI Commission, recently noted:

Congress contemplated an accelerated process for Subchapter V cases, likely as a means to facilitate quicker and cheaper reorganizations. Congress also expressed, however, significant concern for small business debtors, wanting to provide them with a realistic option for reorganizing and saving their business operations. Evidence of this intent is found not only in public commentary but also, more importantly, in the language of Subchapter V itself.9

Because the SBRA provides potentially significant advantages to a debtor, including the sole right to propose a plan, elimination of creditors' committees, elimination of the absolute-priority rule and elimination of the requirement for an impaired accepting class,10 creditors may decide to contest a debtor's eligibility for SBRA relief, which can lead to disputes regarding whether certain obligations count toward the eligibility debt ceiling.

In In re PMI,11 on the petition date the debtor filed a motion to reject 12 parking garage leases

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 ¹¹ U.S.C. § 1181, et seq.
 In re Penland Heating & Air Conditioning Inc., 2020 WL 3124585, at *1 (Bankr. E.D.N.C. June 11, 2020) (slip op.) (citation omitted); see also In re Bonert, 619 B.R. 248, 252 (Bankr. C.D. Cal. 2020)

⁽sankr. C.D. Cal. 2020).
Subchapter V was originally limited to businesses with total debts below \$2.7 million. However, in March 2020, the Coronavirus Aid, Relief and Economic Security Act increased the debt limit to \$7.5 million, allowing larger small businesses to qualify. Absent further change, the limit will have reverted back to \$2.7 million on March 27, 2021. On or about Feb. 25, 2021, Sens. Dick Durbin (D-III.) and Chuck Grassley (R-Iowa) introduced legislation (s. 473) that would, among other things, extend the \$7.5 million debt limit for one additional year.

2020 WL 2193240 (Bankr. D.S.C. April 27, 2020) (*slip op.*).

Section 1182 of the Bankruptcy Code defines a debtor as "small business debtor." The phrase is defined as "a person engaged in commercial or business activities [excluding a person whose primary activity is the business of owning single-asset real estate]."

11 U.S.C. § 101(510). Courts reviewing whether a debtor is "engaged in commercial or business activities" have interpreted that element broadly. See In re Wright, 2020 WL 2193240 (individual debtor who had sold all of his nondebtor business enterprises nev ertheless met definition because he was addressing residual business debt); see also In re Ellingsworth Residential Cmty. Ass'n, 619 B.R. 519 (Bankr. M.D. Fla. 2020) (nonprofit community association was engaged in commercial or business activities and was eli gible to be subchapter V debtor). 6 Fed. R. Bankr. P. 1020.

[&]quot;Proposed Recommendations: Small and Medium-Sized Enterprises (SME) Cases," Final Report of the ABI Commission to Study the Reform of Chapter 11 (2020), available a abiworld.app.box.com/s/uzc6yo7dr8lt1g2m4uxs (unless otherwise specified, all links in this article were last visited on Feb. 23, 2021). Id. at 293.

In re Trepetin, 617 B.R. 841, 846 (Bankr. D. Md. 2020). See also In re Progressive Sols. Inc., 615 B.R. 894, 897 (Bankr. C.D. Cal. 2020) ("[A] well-functioning bankruptcy system, specifically for small businesses, allows businesses to reorganize, preserve jobs, maximize asset values and ensure proper allocation of resources.") (citation omitted) 10 See 11 U.S.C. § 1191(b).

^{11 620} B.R. at 548. The authors serve, respectively, as counsel to the debtor, and counsel to certain equityholders, in the *PMI* case.

as of the petition date. After the court authorized the rejection of five leases as of the petition date (the others were rejected as of a later date), a large creditor objected to the debtor's eligibility under subchapter V, arguing, inter alia, that the lease-rejections damages¹² should count against the subchapter V eligibility cap. 13 Ruling on this objection, and in the absence of subchapter V decisions, the court initially reviewed chapter 12 and 13 debt limitation eligibility decisions for guidance.14

The court noted that other courts have recognized the need to efficiently determine debt eligibility in chapter 12 and 13 cases, 15 and concluded that "Subchapter V presents a similar statutory urgency to resolve eligibility determinations as Chapters 12 and 13."16 While acknowledging this guidance, the court also noted that subchapter V cases are available to entities with more complex creditor relationships than a typical chapter 12 or 13 debtor.¹⁷ For example, few chapter 13 or 12 debtors have substantial PPP funds or a significant number of commercial leases.18

Focusing on lease-rejection claims, the court noted that "[t]he parties dispute whether the lease-rejection claims were contingent as of the petition date."19 The court noted that under § 365, any decision to assume or reject a lease is expressly subject to court approval.²⁰ Accordingly, "rejection is not a unilateral, independent process that can [be] accomplished by the debtor alone."21 Because the order approving lease rejections was not entered until two weeks after the petition date, the lease-rejection claims were contingent obligations until entry of that order.²² The prerequisites to the debtor's lease rejection of any resulting rejection claims were post-petition events.²³ Therefore, the rejection claims were contingent as of the petition date.24

The court also considered whether post-petition events could impact subchapter V eligibility and concluded that like in chapter 13 cases, the answer is "no."25 The court concluded that excluding lease-rejection damages from the debt ceiling because rejection is a post-petition event meets the statutory directive to consider debts as of the petition date and also "has the very real benefit of providing certainty to the process."26 Further, opening eligibility determinations to post-petition events could hinder the expedited process for which subchapter V was designed and nullify the benefits that Congress intended.²⁷ Considering the foregoing factors, the court concluded

12 The Office of the U.S. Trustee joined in this objection with respect to lease rejections, See U.S. Trustee's Objs. to Debtor's Designation as a Small Business Debtor Under Sections 101(51D) and 1182(1), In re Parking Mgmt. Inc., No. 20-15026-TJC (Bankr. D. Md. July 6, 2020), ECF No. 142.

that the lease-rejection claims were contingent as of the petition date and therefore not considered in the debtlimit determination.²⁸

Another issue in the *PMI* subchapter V proceeding was whether the debtor's PPP should have counted toward its total pre-petition debts, for purposes of subchapter V eligibility. The debtor argued that such funds should not count because the PPP is really a grant program rather than a loan, and even if it were a loan, the debt amount is contingent and unliquidated as of the petition date because of the PPP program forgiveness feature.

Outside of the subchapter V eligibility issue, several courts have treated PPP funds as grants rather than loans.²⁹ The PPP "functions like a grant" and "basically provides \$349 billion in grants so small businesses can pay their employees."30 There is no loan underwriting (as there is with other SBA loans), and assuming that the loan proceeds are used as required, the loan will be forgiven.³¹ Another court pointed out that the PPP is not a loan program due to "the fact that no underwriting function is anticipated and the fact that the 'loan' will be completely forgiven if the applicant simply uses 75 percent of the loan proceeds to keep its employees employed."32

In PMI, the debtor also argued that even if the PPP were considered a loan or a debt obligation, it would be an unliquidated and contingent claim as of the petition date because the allowed claim amount, if any, depended on future events, including whether the debtor complied with the applicable regulations and whether it subsequently applied for and obtained loan forgiveness.³³ The creditor argued that the PPP was a loan as evidenced by a promissory note in a fixed amount, and was therefore a noncontingent unliquidated debt as of the petition date.

While acknowledging other bankruptcy court decisions involving PPP funds, the PMI court noted that this was the first time that a court was considering, in the eligibility context, "whether the PPP is a noncontingent and liquidated debt as of the petition date."34 As to the contingent nature of the PPP funds, the court focused on whether all of the events giving rise to the claim had occurred pre-petition or whether liability relied on some future extrinsic event that might not occur.35 To determine the nature of the PPP funds, the court

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¹⁴ Id. at 550.

¹⁶ Id. at 551.

¹⁷ Id. 18 Id

¹⁹ Id. at 552.

²⁰ Id. at 552-53.

²¹ Id. at 553.

²² Id. (citing In re TWA Inc., 261 B.R. 103, 115 (Bankr. D. Del. 2011) (debtor can only seek assumption or rejection after bankruptcy petition is filed and court approval is required))

²³ In re PMI, 620 B.R. at 553.

²⁵ Id. at 554. See, e.g., In re Wiencko, 275 B.R. 772 (Bankr. W.D. Va. 2002); In re Slack, 187 F.3d 1070 (9th Cir. 1999) ("The language of the statute clearly states that the amount of the debt is determined as of 'the date of the filing of the petition." 11 U.S.C. § 109(e) (emphasis added)). Courts that have considered this issue have narrowly construed the quoted portion of § 109(e) holding that a bankruptcy court cannot look to post-petition events to determine the amount of the debt.

^{26 620} B.R. at 554

²⁸ Id. at 555.

²⁹ This issue arose because the Small Business Administration (SBA) refused to approve PPP loans to chapter 11 debtors, and if the PPP program is treated as a grant, then the SBA's refusal could constitute discrimination in violation of § 525(a)

³⁰ In re Gateway Radiology Consultants PA, Case No.19-04971, Adv. P. No. 20-00330 (Bankr. M.D. Fla. June 8, 2020)

³¹ Mem. Op., In re Gateway Radiology Consultants PA, No. 8:19-bk-04971, Adv. P. No. 20-00330 (Bankr M.D. Fla. June 8, 2020), ECF No. 14; see also TRO at 3, In re Organic Power LLC, No. 19-01789, Adv. P. No. 20-00055 (Bankr. D.P.R. May 8, 2020), ECF No. 29 ("[T]he PPP is not a loan program, [but] rather a grant or support program offered by the government to small businesses in financial distress without regard to creditworthiness."): Mem. of Decision at 19. In re Springfield Hosp. Inc., No. 19-10283, Adv. P No. 20-01003 (Bankr. D. Vt. June 22, 2020), ECF No. 63 ("Both subsidized public housing and the PPI

are government grant or support programs aimed at helping people in financial distress."). 32 See, e.g., Opinion and Order at 25, In re Skefos, No. 19-29718, Adv. P. No. 20-00071 (Bankr. W.D. Tenn. June 2, 2020), ECF No. 19; see also Opinion at 13, In re Roman Cath. Church, Adv. P. No. 20-1026 (Bankr. D.N.M. May 1, 2020) ("Unlike PPP loans, the loans to mid-size businesses are intended to be repaid.... [The] Defendant should have read and understood the fundamental differences between the mid-size business loan program (real loans) and the PPP (grants or support payments);" Mem. of Decision at 9, iThrive Health LLC, No. 19-25413, Adv. P. No. 20-00151 (Bankr. D. Md. June 8, 2020), ECF No. 24 (referring to PPP as grant).

³³ The American Institute of Certified Public Accountants (AICPA) has similarly noted that because PPP funds are forgivable if the proceeds are used as required, a borrower may properly account for PPP funds as a grant, rather than a loan. See Ken Tysiac, "AICPA Issues Guidance on Accounting for Forgivable PPP Loans," Journal of Accountancy (June 10, 2020), available at journalofaccountancy.com/news/2020/jun/ forgivable-ppp-loans-aicpa-accounting-guidance.html

³⁴ In re PMI, 620 B.R. at 556.

³⁵ Id. (citing In re Green, 574 B.R.570, 577-80 (Bankr. E.D.N.C. 2017)).

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reviewed the nature of the PPP funds and the debtor's repayment obligations, if any.36 Reviewing the PPP program, the court considered the application process, including the application form that recognizes the potential for loan forgiveness.³⁷ The court also considered the lack of due diligence required, the SBA waiver of typical fees and other basic loan requirements, 38 thus concluding that debt forgiveness was the central purpose of the PPP program.³⁹ Consequently, as of the petition date, a debtor's repayment liability depends on its use of funds, 40 so the PPP funds represented a contingent obligation as of the date the subchapter V petition was filed.⁴¹

The court also concluded that the PPP funds did not constitute a liquidated claim as of the petition date.42 "Liquidated debt" refers to the debt amount, not simply the existence of a debt. 43 Given that the amount of PMI's liability on account of the PPP funding could not be determined as of the petition date, and could turn out to be zero, the "PPP obligation was not liquidated as of the petition date because it was not then known and could not be determined."44 The court concluded that the debtor's obligation to repay the PPP funds was con-

tingent and unliquidated as of the petition date.⁴⁵ Therefore, the PPP debt was excluded from the subchapter V eligibility determination and did not count toward the debt ceiling,46 which made it unnecessary for the court to address the debtor's other argument: that the PPP is not a loan or a debt obligation at all, but instead a grant.

Conclusion

The SBRA was enacted with small, and relatively less complex, cases in mind. This was certainly true when the debt ceiling was initially set at \$2.7 million, but even with the temporarily increased debt ceiling, larger and more complex cases will typically be excluded. However, the exclusion of contingent and unliquidated claims from the debt ceiling including lease- and contract-rejection claims — opens up the possibility of some large and complex subchapter V cases. There might be cases in which fixed debts are relatively low, but the debtor needs chapter 11 for the purpose of rejecting numerous leases. These cases can be large and complex but still fit within subchapter V eligibility. The prospect of moving quickly through chapter 11 — without a creditors' committee, without filing a disclosure statement, without requiring an impaired accepting class and without the absolute-priority rule — might be very attractive to some debtors. abi

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^{36 620} B.R. at 556.

³⁷ *Id.* 38 *Id.* at 557

³⁹ Id. at 558 (citing "Paycheck Protection Program," U.S. Small Bus. Admin., available at sba.gov/fundingprograms/loans/coronavirus-relief-options/paycheck-protection-program) 40 620 R R at 558

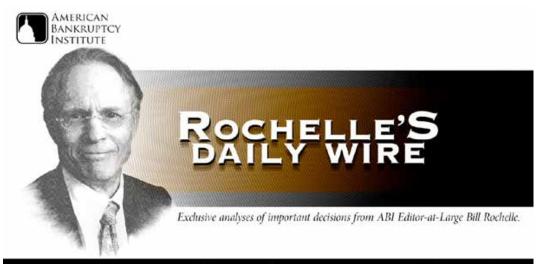
⁴¹ Id. at 559.

⁴² ld.

⁴³ Id.

⁴⁵ Id. at 555

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Selling Assets of a Defunct Business Is a Legitimate Activity in 'Sub V,' Florida Judge Says

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Bankruptcy Judge Lori V. Vaughan of Orlando, Fla., squarely held that a corporate debtor is eligible to sell the assets and liquidate in Subchapter V of chapter 11, even if the company had terminated normal operations before filing.

Just to distribute assets that already had been liquidated, the decision allows the estate to avoid the (probably unnecessary) expenses that would result from conversion to chapter 7 and appointment of a trustee.

Judge Vaughan's July 23 opinion means that the sale and liquidation of assets is a legitimate activity in Subchapter V not requiring oversight from a trustee in chapters 7 or 11.

The corporate debtor had been a contractor. Claims of shoddy construction led to lawsuits that the insurer defended. Unable to renew insurance, the debtor shut down the business and filed a petition under Subchapter V of chapter 11.

The petition listed assets of some \$300,000, including a \$13,000 bank account and accounts receivable with a face value of \$200,000. The schedules listed \$800,000 in unsecured claims and another 200 unliquidated, disputed construction claims.

Soon after filing, the debtor filed a motion to sell the assets under Section 363. Before the court approved the sale, the U.S. Trustee objected to the debtor's right to proceed under Subchapter V.

The U.S. Trustee claimed that the debtor was ineligible for Subchapter V because there were no business operations on the filing date. In essence, the U.S. Trustee was contending that Subchapter V may only be used to reorganize and may not be employed to liquidate assets.

The Small Business Reorganization Act, or SBRA, became effective in February 2020 and is codified primarily in Subchapter V of chapter 11, 11 U.S.C. §§ 1181 – 1195. To be eligible for Subchapter V, the debtor must have less than \$7.5 million in debt and must be "a person engaged in commercial or business activities" See Sections 1182(1) and 101(D)(A).

Judge Vaughan ruled in favor of the debtor. In her view, the statutory words "commercial or business activities" are not ambiguous. She focused on the debtor's activities on the filing date.

Consulting dictionaries, Judge Vaughan said that the "term 'commercial' is commonly understood to involve commerce." The term "business," she said, "has a similar meaning."

Citing cases such as *Offer Space* and *Ikalowych*, Judge Vaughan concluded that "the plain meaning of engaged in 'commercial or business activities' is broad with a very inclusive range of commercial or business activity." To read ABI's reports on those two cases, click <u>here</u> and <u>here</u>.

On the filing date, the debtor was not operating. However, the debtor had bank accounts, was working with insurance adjusters to resolve claims, and was engaged in selling the assets. "These acts were commercial or business in nature" and were being conducted "with a view toward profit, or at least minimizing loss," Judge Vaughan said.

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By "maintaining bank accounts, working with insurance adjusters and insurance defense counsel to resolve the Construction Claims and preparing for the sale of its assets," Judge Vaughan held that the debtor was engaged in commercial or business activities on the petition date and was thus eligible for Subchapter V.

Judge Name: Lori V. Vaughan

Case Citation:

In re Vertical Mac Construction LLC, 21-1520 (Bankr. M.D. Fla. July 23, 2021).

Case Name:

In re Vertical Mac Construction LLC

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Feature

By Michael Jones

The New Requirement of **Protecting Creditors from Default Under Subchapter V**

ection 1191 of title 11 provides that a debtor can only confirm a nonconsensual subchapter V chapter 11 plan if the plan is fair and equitable as to impaired interest-holders that have not accepted the plan. To be "fair and equitable," the court must find that the debtor either will be able to make all the payments under the plan (i.e., there is certainty of performance), or that there is a reasonable likelihood that the debtor will be able to make all the payments under the plan (i.e., the debtor will probably perform under the plan).2

The plan must contain some protection for the impaired creditors that have not accepted the plan in the event that the debtor does not perform as required,3 although the plan proponent is free to develop whatever mechanisms will work for the circumstances of the case. Section 1191(c)(3)(B) provides no parameters for the remedies under this section, so a plan proponent has the liberty to fashion its own.

While the Bankruptcy Code states that appropriate remedies "may include the liquidation of nonexempt assets,"4 it does not require it. This article offers other suggestions for use in a subchapter V chapter 11 plan.



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Provisions for Secured Creditors

Nearly all chapter 11 plans have both secured and unsecured creditors. The plan must provide appropriate remedies for "holders of claims or interests" that are to receive payments under the plan.5 The fair-and-equitable requirement for confirmation of a nonconsensual plan must accommodate both secured and unsecured parties that are impaired and have not accepted the plan. Without such provisions, the plan cannot be confirmed.6

Providing protection for secured creditors that meets the "appropriate remedies" standards of § 1191(c)(3)(B) is usually easy. Simply allow a

1 A "consent plan" is confirmed under 11 U.S.C. § 1191(a), but a nonconsensual plan is confirmed under 11 U.S.C. § 1191(b) if it is fair and reasonable to the non-accepting par-ties. It is 11 U.S.C. § 1191(c) that requires appropriate remedies in the event of default by the reorganized debtor in order to be "fair and reasonable."

11 U.S.C. § 1191(c)(3)(A).

11 U.S.C. § 1191(c)(3)(B).

- 4 Emphasis added
- 5 11 U.S.C. § 1191(c)(3)(B). 6 11 U.S.C. § 1191(b).

creditor to retain its lien, such as this sample from a subchapter V plan in the District of Utah:7

Retain Liens. The holders of Allowed Class 6 Claims shall retain their Liens [as collateral] until their Claims are paid in full.

Provisions for Unsecured Creditors Liquidation of Assets

Liquidation is the only remedy that is specifically identified in the Bankruptcy Code as a possible means of protecting creditors.8 The proposed remedy could be either voluntary or involuntary liquidation of assets.

Voluntary Liquidation of Assets: The following example is from a subchapter V plan in the Central District of California.9 It allows the reorganized debtors to liquidate assets at their discretion in order to satisfy their obligations to creditors:

Intentional Liquidation of Assets

The Debtors may elect to liquidate the Debtors' property ... at any time following the Effective Date if it is so deemed in the sole judgment, discretion, and opinion of the Debtors to be in the best interests of the Debtors' ability to fulfill the obligations under the Plan.

In the event of the liquidation of a secured asset, all liens related to the asset being liquidated must be paid in full at the time of the liquidation. The Debtors may thereafter use the net proceeds from the sale of the asset in a manner the Debtors believe will best allow them to meet the obligations under the Plan.

This provision allows a secured creditor to be paid from the liquidation of its collateral, then allows any additional funds from the sale of the asset to be used to pay other parties (e.g., unsecured creditors) under the plan. The problem is that § 1192(c)(3)(B) explicitly states that the "appropriate remedies" requirement is to "protect the holders of claims or interests,"10 not to merely provide flexibility to the debtor in how a claim is paid.

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Chapter 11 Plan (Under Subchapter V), *In re Desert Lake Grp. LLC*, Case No. 20-22496 (Bankr. D. Utah July 23, 2020), Docket No. 21. 11 U.S.C. §1191(c)(3).

Subchapter V Chapter 11 Plan of Reorganization Dated Jan. 18, 2021, In re Lawrence Shermon Joe, et al., Case No. 20-19575 (Bankr. C.D. Cal. Jan. 19, 2021), Docket No. 33.

Thus, there may be a need to include involuntary liquidation provisions.

Involuntary Liquidation of Assets Within Chapter 11: To protect unsecured creditors, a plan proponent may provide for the involuntary liquidation of assets, probably by the subchapter V trustee. A plan proponent other than the debtor is most likely to include a remedy for the involuntary liquidation of assets; it is unlikely a debtor would provide for the "involuntary liquidation of its own assets." Even the threat of such action may prompt payment of claims if at all possible. Accordingly, a plan should require a notice of default and an opportunity to cure. Only if the default is not cured may the aggrieved party seek an order involuntarily liquidating designated assets of the debtor.

Such a default provision could allow the debtor to retain some control over what assets are liquidated. For example, a chapter 11 plan could designate what assets would be liquidated first, *how* they would be liquidated (*e.g.*, sale to insiders at a preset price) and by whom. The debtor has no control in a chapter 7 liquidation apart from allowed exemptions (if any). Here is a sample for a notice of default and opportunity to cure from an actual confirmed subchapter V plan in Utah:¹¹

Default of Plan; Notice Required. In the event of any material default of the provisions of this Plan, the Subchapter V Trustee, a creditor or other party in interest aggrieved by such default may provide written notice to the Reorganized Debtor and to the Subchapter V Trustee (a "Default Notice"). The Default Notice must describe with specificity the nature of the default alleged and the steps required of the Debtor (or, if applicable, the Subchapter V Trustee) to cure such default.

Opportunity to Cure. The Reorganized Debtor (or, if applicable, the Subchapter V Trustee) shall have thirty (30) days after receipt of a written Default Notice to cure such default. The aggrieved Person shall take no further action until at least thirty (30) days have passed and the Debtor (or, if applicable, the Subchapter V Trustee) has not cured or substantially complied with the Default Notice. Even after the thirty- (30-) day period has expired, the Reorganized Debtor (or, if applicable, the Subchapter V Trustee) may cure a default at any time, even after an application or motion has been filed by an aggrieved party.

If the default remains uncured, the plan can allow the aggrieved party to seek an order compelling compliance or ordering the subchapter V trustee to act, such as in this example:

Treatment of Uncured Default of Plan. If the Reorganized Debtor defaults in its obligations under the Plan, and after the required notice and opportunity to cure, the default remains uncured, the aggrieved party may bring the matter before the Bankruptcy Court, and the Court may thereafter order the Subchapter V Trustee to liquidate the identified asset and disburse the proceeds as appropriate to pay the

11 Chapter 11 Plan (Under Subchapter V), In re Desert Lake Grp. LLC, Case No. 20-22496, (Bankr. D. Utah July 23, 2020), Docket No. 21.

obligations under the plan or provide such other relief at the Court's discretion.

Retention of Estate Assets

Some creditors might be concerned that the reorganized debtor will pillage all the assets of the company after confirmation by conveying them to a successor entity. Without assets to liquidate and pay creditors, the unsecured creditors would have no recourse except perhaps to pursue costly fraudulent conveyance litigation. This might arise when the debtor owns intellectual property as its primary assets (e.g., software or patents). To address this concern, a plan proponent may consider including a provision barring the reorganized debtor to sell certain assets and requiring them to be retained in the estate after confirmation.

Ordinarily, the confirmation of a chapter 11 plan will "vest all the property of the estate in the debtor," enabling the debtor to sell the property without any court supervision. However, a plan proponent can eliminate this possibility using the § 1141(b) exception to the automatic re-vesting: "Except as otherwise provided in the plan or order confirming the plan." The plan can prevent the debtor from conveying its assets by not returning full ownership of the assets to the debtor until plan is complete.

Historically, the requirement to pay U.S. Trustee quarterly fees created a huge incentive to obtain a final decree and close a chapter 11 case. ¹³ However, under subchapter V, there are no quarterly U.S. Trustee fees. A chapter 11 case can now remain open for an extended period of time without great expense to the reorganized debtor. Here is a sample provision to consider:

Retention of Property in the Estate. Upon confirmation, all property of the estate will vest in the Debtor except for the following intellectual property, hereinafter referred to as "retained property": [description of retained property]. The Debtor may continue to use the retained property without restriction in the same normal and ordinary way it would be used by an entity in the Debtor's industry and trade, however, the Debtor may not encumber, transfer, convey any interest of, or sell the retained property without approval of the Court pursuant to a noticed motion under 11 U.S.C. § 363.

Granting New Security Interests

Another way to protect unsecured creditors is to transform them into secured creditors through the plan. Debtors should be aware that this may impair their ability to obtain exit financing or future post-confirmation credit.

An intangible asset that is often available is the accounts receivable of the debtor. A retailer could potentially grant an interest in their inventory or fixtures. Care should be taken to not violate other financing agreements that restrict junior liens against these kinds of assets.

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^{12 11} U.S.C. § 1141(b)

¹³ In an individual chapter 11 case, the debtor is not usually eligible for a discharge until the plan payments are completed (11 U.S.C. § 1141(d)(5)). To avoid paying U.S. Trustee fees for three to five years, individual debtors routinely request an "interim closure" of their case while they perform under the terms of the confirmed plan.

New Requirement of Protecting Creditors from Default Under Subchapter V

What if there are multiple creditors within the class that would not have the same priority in the collateral? A plan might need a distribution trust to hold the security interest for the benefit of the various class members. However, this is complex and could incur the significant cost of an institutional trustee for the distribution trust.

A simpler way to grant a security interest to multiple class members is to provide "race" provisions that shift the burden of obtaining and perfecting the security interest to the creditors. In actual practice, this would likely result in the security interest never being requested or perfected, and would negate the risk of impairing future financing.

Here is an example from a subchapter V plan in the Central District of California that grants a security interest.¹⁴ The creditor must request the grant of a security interest, then perfect its interest by filing a Uniform Commercial Code financing statement:

To protect the unsecured creditors, upon the request of any unsecured creditor within 180 days following the Effective Date, the Debtor will execute and provide to the unsecured creditor documents providing the grant of a security interest in all property of the Debtor, including the intangible assets (e.g., contract rights, cash collateral, and accounts receivable) of the Debtor. Although the Debtor will provide said document(s) to the requesting creditor, the Debtor will take no steps to record the documents in such a way as to perfect the security interest as provided by Article 9 of the Uniform Commercial Code; it is incumbent on the creditor to timely perfect their security interest. Creditors should also be aware that their priority in the collateral will vary, depending on the order in which the security interests are granted, which will be on a "first-come, first-served" basis by the Reorganized Debtor.

Third-Party Guarantees

Creditors often seek a third party that will guarantee payment. The downside to having a third-party guarantee as a creditor's default remedy is that it may require litigation to actually be paid (i.e., suing the guarantor).

The common candidates for a third-party guarantee are the debtor's interest-holders. However, insiders may have already guaranteed the obligation of the business when the debt was initially incurred, effectively giving the creditors nothing more than they already have. As such, in actual practice the third-party guarantee for a business debtor might not provide the required protection.

If the debtor is an individual, they may get their parents, siblings or a close friend to guarantee performance. In those instances, this solution might work. Here is a sample, typical, third-party guarantee clause for a chapter 11 plan:

[The third-party guarantor] (hereinafter "the guarantor") personally and individually guarantees unconditionally full and prompt payment of obligations due under this Chapter 11 Plan for the Debtor and any successor in interest. A written personal guarantee, executed and notarized by the guarantor, is attached to the Plan as Exhibit C.

Payment Bonds

An alternative to a traditional third-party guarantee is to obtain a payment bond. Payment bonds are commonly used in the construction industry. It is an insurance product that provides payment when the primary obligor defaults. The interest-holder of the debtor will invariably be required to personally guarantee the bond to the issuer.

The cost of a payment bond (i.e., the insurance cost) is usually calculated as a percentage of the payment being protected. The actual percentage used will vary based on a number of factors, including the interest-holder's personal credit score. If the interest-holder has a credit score exceeding 700, the percentage paid will likely be between 1 and 4 percent. Integration of a payment bond in a subchapter V plan might use language like this:

Payment Bond. The payment of obligations due under this Chapter 11 Plan are insured through a payment bond issued by [the bond issuer] that guarantees payment in the event of a default by the Debtor. A copy of the bond, complete with details on the surety, is attached to the Plan as Exhibit C.

Conclusion

Unless a subchapter V plan is a consent plan, the plan must provide a remedy for creditors that will satisfy the court that the creditors will be paid as agreed to in the plan. Because the Bankruptcy Code does not constrain the plan by requiring a particular means of protection, a plan proponent can be as creative as necessary to meet the requirements of 11 U.S.C. § 1191(c)(3)(B). The ideas presented in this article are merely illustrative of the many options available to a plan proponent, who must tailor the remedies to the particular circumstances. abi

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¹⁴ Subchapter V Chapter 11 Plan of Reorganization Dated Oct. 14, 2020, In re Vantage Point Apparel Software Inc., Case No. 20-10936 (Bankr. C.D. Cal. Oct. 14, 2020), Docket No. 44.

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No Vote, No Problem — Right? Novel Ethical Implications of a Subchapter V Bankruptcy Nonconsensual Plan

Committee: Ethics and Professional Compensation



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The Small Business Reorganization Act of 2019, also known as SBRA (Pub. L. No. 116-54), became effective on Feb. 19, 2020. This legislation allows a small business debtor to choose, during the filing process, to proceed under subchapter V within chapter 11. A primary legislative goal behind the SBRA is to expedite the reorganization process for small businesses by enabling them to confirm a plan with the aid of a private trustee, specifically a subchapter V trustee. [2] The key provisions of the SBRA aim to enhance a debtor's capacity to negotiate a successful reorganization while maintaining control of its business. [3] Additionally, the legislation seeks to minimize unnecessary procedural burdens and costs by eliminating such requirements as the creditors' committee and disclosure statement for the reorganization plan. [4]

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In chapter 11 bankruptcy, the acceptance of a plan by secured creditors is crucial for determining compliance with the "cramdown" provisions of § 1129(b). If a class of creditors is both unaccepting and impaired, the bankruptcy court can only confirm the plan if at least one other impaired class has accepted it. [5] However, subchapter V cases, which are governed by 11 U.S.C. § 1191, have their own specific cramdown criteria. Section 1191(a) provides that "[t]he court shall confirm a plan under this subchapter only if all of the requirements of section 1129(a) ... are met." [6] However, § 1191(b) allows confirmation even if paragraphs (8), (10) and (15) of § 1129(a) are not met, provided the plan is "fair and equitable" for each impaired nonaccepting class. [7] Section 1191(c) defines "fair and equitable" under nonconsensual plans, incorporating discretionary and mechanical criteria. [8]

Notably, subchapter V allows cramdown confirmation without the satisfaction of § 1129(a)(10). As such, confirmation is possible in subchapter V cases, even if no impaired class of creditors accepts the plan. The trustee may still object to confirmation if criteria in § 1191(b) and (c) are not met in cramdown cases.[9]

There are inevitably cases that involve creditors who may be unsophisticated, negligent or apathetic. For those who are apathetic or negligent, a swift bankruptcy process that relies on the discretion of the court and the trustee to safeguard creditors' interests might be deemed reasonable and efficient. However, when dealing with unsophisticated creditors, particularly in the context of subchapter V, an ethical dilemma arises: Is prioritizing reorganization over due process justified?

Due process is a fundamental right embedded in the U.S.'s foundational documents, and legal professionals are trained on its procedural and substantive requirements. Chapter 11 bankruptcy proceedings are intricate mechanisms designed to facilitate the financial restructuring of businesses facing insolvency. It is not rare that creditors, even secured creditors, that are owed large sums of money lack the sophistication to promptly and effectively engage in the bankruptcy process — even in slower, more conventional chapter 11 processes.

In subchapter V, the pace is accelerated, with the debtor required to submit a status report within six weeks and a reorganization plan within three months of filing.[10] The primary objectives of subchapter V are to address obstacles to successful reorganization for small businesses by relaxing chapter 11's complex requirements, reducing costs and expediting the

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process.[11] This combination of speed and relaxed standards, including nonconsensual confirmation, introduces a unique element in bankruptcy: plans confirmed without the consent of any interested parties other than the debtor, relying on the trustee and the court's *sua sponte* investigation as safeguards.

"A court of bankruptcy is a court of equity, seeing to administer the law according to its spirit, and not merely by its letter." [12] Under these novel regimes of change in the subchapter v context, a practitioner cannot help but wonder whether enabling such an automatic mechanical option for confirmation, even in rare circumstances

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[2] See U.S. Department of Justice Executive Office for United States Trustees, Handbook for Small Business Chapter 11 Subchapter V Trustees February 2020, p. 1-1.

- [3] *Id*.
- [4] *Id*.
- [5] See 11 U.S.C. § 1129(a)(10).
- [6] 11 U.S.C. § 1129(a).

[7] See 11 U.S.C. § 1129(b); Subsection (a)(8) mandates unanimous acceptance from all impaired classes for the plan. As a precondition for cramdown under 11 U.S.C. § 1129(b), subsection (a)(10) necessitates acceptance from at least one impaired class of claims. Additionally, subsection (a)(15) stipulates that in cases where an unsecured creditor objects to the plan filed by an individual debtor, the debtor must pay the greater of the claim amount or the debtor's projected disposable income over five years.

- [8] See 11 U.S.C. § 1129(c).
- [9] See 11 U.S.C. § 1183(b)(3).
- [10] See 11 U.S.C. § 1188.

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[11] See Hon. Paul W. Bonapfel, "A Guide to the Small Business Reorganization Act of 2019," 93 Am. Bankr. L.J. 571, 574 (2019).

[12] Johnson v. Norris, 190 F. 459, 463 (5th Cir. 1911).

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[+] FEEDBACK

Feature

By Joshua A. Lesser and Suntrease Williams-Maynard

A Categorical Review of Abuses: From Civil Bad Faith to Criminal Bankruptcy Fraud



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his article explores two questions. First, what are the sources of authority for civil bad-faith dismissal or conversion of a bankruptcy proceeding, and how is it defined? Second, what is criminal bankruptcy fraud, and how is it different from civil bad faith? This article concludes that they are not as different as one might think, often arising from similar facts, and that practitioners and professionals should keep both in mind when advising their clients.

Authority for Civil Bad Faith in the Bankruptcy Code

Bankruptcy courts regularly rely on §§ 707, 1112 and 1307 of the Bankruptcy Code in ordering the dismissal or conversion of a "bad faith" bankruptcy filing. However, none of these sections mentions "bad faith"; rather, these sections provide that the court may (or, in § 1307, shall) convert or dismiss a case, whichever is in the best interests of the creditors, "for cause."

Often citing the equitable nature of bankruptcy courts' jurisdiction, every court of appeals (except for the Court of Appeals for the Federal Circuit) has held that "for cause" as used in these sections is not confined to the illustrative list of examples provided in each section, but includes an unenumerated grant of authority to convert or dismiss a filing for "bad faith."

Defining Civil "Bad Faith"

The courts of appeals have fashioned numerous tests over the years, but presently and most often rely on a "totality of the circumstances" approach to determine whether a bankruptcy petition was filed in bad faith. In the context of a voluntary filing, the Fifth Circuit in *In re Krueger* advised that the inquiry must

focus on "the debtor's entire course of conduct — before, during, and after the filing of a ... petition."

In Krueger, the court held that the debtor's conduct was "paradigmatic of the need for cause to include bad faith" because it constituted "a concerted scheme to use the bankruptcy process as both a shield from legitimate state court actions and a sword to retake control" of the company at stake in pending state court litigation.4 The debtor admitted that his purpose in filing for bankruptcy was to avoid a pending criminal contempt proceeding arising out of the state litigation; avoid a summary judgment pending in the state court; delay the state litigation; and avoid the state court forum because he thought the Austin, Texas, judges were biased against him.⁵ In upholding dismissal, the Fifth Circuit also cited the debtor's failure to make complete disclosures, use of a fake address in his bankruptcy petition, perjuring himself on the record and threatening a witness.6

While these facts tended toward the more egregious, they reflect some common elements of bad faith. These include a pre-filing transfer of assets, pending state court litigation not going the debtor's way, inaccurate schedules and statements, and unavailing explanations for what the Eighth Circuit called "non-economic motives ... unworthy of bankruptcy protection."7 While the totality of the circumstances is a fluid test, common elements include the following: (1) the nature, source, and type of the scheduled debt(s); (2) the timing and circumstances surrounding the petition; (3) the accuracy of the debtor's financial statements; (4) attempts by the debtor to mislead the bankruptcy court; (5) the debtor's apparent motivation in filing; and (6) whether the debtor was forthcoming with the bankruptcy court and the creditors.8

While many of these factors — especially those that go toward the debtor's apparent motive and intent — require a discerning and decisive judge, the Southern District of New York noted that while bad-

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¹ Section 707 of the Bankruptcy Code provides authority for dismissal or conversion of a chapter 7 petition; § 1112 is the same for a chapter 11 petition; and § 1307 is the same for a chapter 13 petition.

² See In re Marrama, 430 F.3d 474, 479 (1st Cir. 2005), aff'd sub. nom., Marrama v. Citizens Bank of Massachusetts, 549 U.S. 365 (2007); In re First Connecticut Consulting Grp. Inc., 254 Fed. App'x 64, 68 (2d Cir. 2007); In re Mondelli, 558 Fed. App'x 260, 263 (3d Cir. 2014); In re Forever Green Athletic Fields Inc., 804 F.3d 328, 336 (3d Cir. 2015); Janvey v. Romero, 838 F.3d 406, 412 (4th Cir. 2018); In re Krueger, 812 F.3d 365, 370 (5th Cir. 2016); In re Charloos, 979 F.2d 390, 392 (6th Cir. 1992); In re Whaley, 772 Fed. App'x 346, 348 (7th Cir. 2019); In re Zepeck; 141 F.3d 1172 (8th Cir. 1998); In re Eisen, 14 F.3d 469, 470 (9th Cir. 1994); In re Gier, 986 F.2d 1326, 1329 (10th Cir. 1993); In re Piazza, 719 F.3d 1253, 1267 (11th Cir. 2013); King v. States Res. Corp., 233 Fed. App'x 1, 2 (D.C. Cir. 2007).

³ In re Krueger, 812 F.3d 365, 372 (5th Cir. 2016).

⁴ *Id.* at 5 *Id.*

⁶ Id.

Huckfeldt v. Huckfeldt (in re Huckfeldt), 39 F.3d 829, 832-33 (8th Cir. 1994); see also in re Krueger, 81F.3d at 372.
 See, e.g., in re Marrama, 430 F.3d 474, 482 (1st Cir. 2005), aff'd sub. nom., Marrama

⁸ See, e.g., In re Marrama, 430 F.3d 474, 482 (1st Cir. 2005), aff'd sub. nom., Marrama v. Citizens Bank of Massachusetts, 549 U.S. 365 (2007); In re Mondelli, 558 Fed. App'x

faith dismissal "is an extraordinary remedy that requires careful examination of the facts on a case-by-case basis ... where the circumstances require such relief, and the cases granting both types of motions are legion, a judge must not shrink from ordering it." In the context of an involuntary petition filed by creditors, common "bad faith" inquiries include whether:

- 1. the petition was meritorious;
- 2. the creditors made a reasonable inquiry into the facts and law before filing;
- 3. there was evidence of preferential payments;
- 4. the petitioning creditor(s) used the filing to obtain a disproportionate advantage;
- 5. the filing was used as a tactical advantage in pending actions;
- 6. the filing was used as a substitute for customary debtcollection procedures; and
- 7. the filing had suspicious timing.¹⁰

Overall, the court's inquiry focuses on, as the Fifth Circuit stated, whether the filing "consitut[ed] an abuse of bankruptcy process ... or petitions that simply serve no legitimate bankruptcy purpose."11

Criminal Bankruptcy Fraud

Section 157 of the U.S. Criminal Code¹² makes it a felony offense to "devise a scheme or artifice to defraud," and in furtherance of such, to (1) file a bankruptcy petition (whether voluntary or involuntary); (2) file a document in a proceeding under the Bankruptcy Code, or (3) make a false or fraudulent representation in relation to a bankruptcy proceeding.¹³ Even though § 157 does not contain specific words indicating scienter, it is generally regarded as a "specific intent" crime, meaning that it requires proving the unlawful act, and a subjective intent or object to achieve the unlawful result.¹⁴ This is a stricter standard than "general intent," which only requires proving an intent to do the act that brought about the unlawful result (but not necessarily the unlawful result itself).15 A mistake of fact may serve as a defense to specificbut not general-intent crimes.16

For example, in USA v. James Lee Clark, the U.S. Attorney's Office filed a 17-count indictment in the U.S. District Court for the Middle District of Florida alleging that the defendant — an attorney — conspired to violate and did violate § 157 of the Criminal Code (as well as wire fraud for mishandling client funds).¹⁷ The overall scheme allegedly involved the defendant securing title to distressed properties in exchange for his promise to represent the owner in bankruptcy.18 It was further alleged that the defendant either collected rent payments from the owner, or relocated the owner and rented the property out to third parties and would, when foreclosure proceedings were initiated, file for bankruptcy and immediately file a suggestion of bankruptcy.¹⁹ It was further alleged that the defendant would not pursue the bankruptcy but would allow it to be dismissed, usually for failure to file schedules and statements.20

In that case, the defendant has, as of the writing of this article, agreed to plead guilty to one count of conspiracy to commit § 157 bankruptcy fraud and one count of wire fraud.²¹ The penalties for these crimes include a maximum sentence of 20 years and a fine of up to \$250,000 for wire fraud,²² and a maximum sentence of five years and a fine of up to \$250,000 for conspiracy to commit bankruptcy fraud (the same penalty as bankruptcy fraud).23

Section 152 of the Criminal Code provides additional grounds for a felony offense against any person who, among other things, "knowingly and fraudulently conceals ... in connection with a case under [the Bankruptcy Code] ... any property belonging to the estate of a debtor;" "knowingly and fraudulently makes a false oath or account in or in relation to any case under [the Bankruptcy Code];" or "knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under [the Bankruptcy Code], in a personal capacity or as or through an agent, proxy, or attorney."24 These are only three of the nine independent bases for a felony conviction under § 152.25

While "knowingly" is not an exact standard, 26 courts generally consider § 152 to be a specific-intent crime because of, at least, the inclusion of "fraudulently."²⁷ As with § 157, a conviction under § 152 carries a maximum term of imprisonment of five years, and a penalty of up to \$250,000.28

Conclusion

Practitioners, parties and professionals should be aware of not only bad-faith filings in the context of the Bankruptcy Code, but of the various types of bankruptcy fraud in the context of the Criminal Code. While criminal liability is generally predicated on a finding of specific intent, this (as with many fraud crimes) can be drawn from circumstantial evidence.2

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9 In re 234-6 W. 22nd St. Corp., 214 B.B. 751, 757 (Bankr, S.D.N.Y. 1997).
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22 See 18 U.S.C. §§ 1343, 3571.

19 *ld.* 20 *ld.*

21 ld

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¹⁰ In re Forever Green Athletic Fields Inc., 804 F.3d 328, 336 (3d Cir. 2015).

¹¹ In re Krueger, 812 F.3d 365, 370 (5th Cir. 2016) (quotation marks and citations omitted).

^{13 18} U.S.C. § 157.

¹⁴ See United States v. Spurlin, 664 F.3d 954, 964 (5th Cir. 2011); United States v. Daniels, 247 F.3d 598, 601 n.3 (5th Cir. 2001); see also United States v. Britton. 289 F.3d 976, 981 (7th Cir. 2002) ("Intent to defraud requires a [willful] act by the defendant with the specific intent to deceive or cheat, usually for the purpose of getting financial gain for one's self or causing financial loss to another."). 15 See Daniels, 247 F.3d at 601 n.3; see also United States v. Lamott, 831 F.3d 1153, 1156 (9th Cir. 2016).

¹⁶ Lamott, 831 F.3d at 1156 ("The practical difference between [specific- and general-intent crimes] is that certain defenses, like factual mistake and voluntary intoxication, can negate culpability for specific-intent

crimes but not for general-intent crimes.").

17 USA v. James Lee Clark, 20-00199 (M.D. Fla. filed March 12, 2020).

¹⁸ Id. (Docket No. 1)

²³ See 18 U.S.C. §§ 157, 371, 3571. 24 18 U.S.C. § 152. 26 For a discussion of the varying intent standards applied to "knowingly." see United States v. Starnes, 583

F.3d 196, 209 (3d Cir. 2009). 27 See United States v. Gellene, 182 F.3d 578, 586 (7th Cir. 1999) ("The common understanding of the term 'fraudulently' includes the intent to deceive.") (footnote omitted); United States v. McCormick,

⁷² F 3d 1404 1410 (9th Cir. 1995) ("The crime for which she stands convicted [18 II S C 8 152] however, requires evidence of her specific intent to fraudulently conceal assets from the bank 28 18 U.S.C. §§ 152, 3571.

²⁹ See, e.g., United States v. Persfull, 660 F.3d 286, 294 (7th Cir. 2011) ("Because direct evidence of a defendant's fraudulent intent is typically not available, specific intent to defraud [under 18 U.S.C. § 157] may be established by circumstantial evidence and by inferences drawn from examining the sc itself," (alteration, quotation marks and citation omitted)); United States v. McCormick, 72 F.3d at 1406 ("This evidence provided sufficient circumstantial evidence from which the jury could find the fraudulen intent required for a conviction under 18 U.S.C. § 152."); United States v. Stein, 233 F.3d 6, 22 (1st Cir. 2000) (upholding § 152 conviction, reasoning that "even if Otis had been unaware of the concealment at the time of the conveyance, there is ample circumstantial evidence for a jury to find that she later was knowingly and willfully involved in the conspiracy").

A Categorical Review of Abuses: From Civil Bad Faith to Criminal Fraud

The casual observer might be quick to draw distinctions between the cases involving civil bad faith and criminal bankruptcy fraud — and indeed, distinctions generally do exist. However, the only true differentiator between many typical bad-faith cases, such as one involving the transfer or concealment of assets, is that *scienter* element.³⁰ The keen observer would note that specific intent might be inferred from the nature and timing of transactions by which debtors

often attempt to conceal or transfer assets. By being aware

of this narrow distinction, practitioners may ensure that they, their clients, and their professionals are insulated not just by the U.S. Attorney's discretion, but by the law. abi

30 Indeed, this blurred line is highlighted by a review of § 548 of the Bankruptcy Code, titled "Fraudulent transfers and obligations," which is eerily close to §§ 152 and 157 of the Criminal Code. Compare 11 U.S.C. § 548(a)(1)(A) ("The trustee may avoid any transfer ... or any obligation ... incurred by the debtor ... if the debtor voluntarily or involuntarily ... made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud."); with 18 U.S.C. §§ 152, 157. While the standard for a "fraudulent transfer" in the context of the Bankruptcy Code might be lower (including, "involuntar[ly]" intent to "hinder" or "delay"), there is certainly enough overlap to call for caution.

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Finality of a Contempt Order Drawn into Ouestion in the Eleventh Circuit | ABI





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DECEMBER 11, 2023

Finality of a Contempt Order Drawn into Question in the Eleventh Circuit

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Some authority from the Supreme Court suggests that a contempt order without imposition of attorneys' fees would not be final in a bankruptcy case.

In a case involving the finality of a contempt order for violating the automatic stay, a judge on the Eleventh Circuit hints that her circuit's precedent may be out of step with Supreme Court authority.

Bound by its own precedent, the Eleventh Circuit held that an order in a contempt proceeding is nonfinal and nonappealable until the bankruptcy court fixes the award of attorneys' fees in later proceedings. Relying on earlier Supreme Court's authority, the district court believed that the appeal should

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have been taken immediately after the contempt finding, although damages and attorneys' fees were left open at the time.

Contempt and Attorneys' Fees

Before bankruptcy, the corporate debtor had been suing a local government for disclosure of documents under the state's public records act. The debtor and the city settled but left open the question of whether the debtor was entitled to costs and attorneys' fees.

The day before the hearing in state court on attorneys' fees, the debtor filed a chapter 11 petition. The debtor argued in state court that the automatic stay precluded a hearing on its own fee request.

The city countered in state court by contending that the automatic stay did not apply because the debtor was on the offensive. The state court agreed with the city but decided to withhold a ruling on attorneys' fees until the conclusion of the bankruptcy.

Six weeks after the hearing in state court, the debtor moved in bankruptcy court to hold the city in contempt of the automatic stay. The bankruptcy court disagreed with the state court and held that the city had violated the automatic stay.

The bankruptcy court entered an order finding the city in contempt and liable for violating the stay. The contempt order also declared that the city would be liable for the debtor's attorneys' fees in an amount to be decided in further proceedings. The contempt order ruled that the debtor was entitled to neither compensatory nor punitive damages.

The city did not appeal the contempt order.

Weeks later, the bankruptcy court conducted a hearing and held the city liable for about \$13,000 in attorneys' fees. The city then appealed both the contempt order and the order granting the debtor \$13,000 in attorneys' fees.

The city appealed, presumably to argue under *Taggart v. Lorenzen*, 139 S. Ct. 1795, 1799 (2019), that there was no contempt because the city had an

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"objectively reasonable basis" for contending there was no violation of the automatic stay.

The district court dismissed the appeal, believing that the appeal from the contempt order was untimely. The city appealed to the Eleventh Circuit.

Conflicting Supreme Court Authority

In her December 5 opinion for the appeals court, Eleventh Circuit Judge Robin S. Rosenbaum said she understood why the district court believed the contempt order was a final order requiring an immediate appeal. "After all," she said, the contempt order "left only the determination of attorneys' fees, so a straight-forward application of the 'bright-line rule' from *Budinich* and *Ray Haluch* yields the conclusion that the Contempt Order was a 'final decision.'"

Judge Rosenbaum was referring to *Budinich v. Becton Dickinson & Co.*, 486 U.S. 196, 199 (1988), where she characterized the Supreme Court as holding under 28 U.S.C. § 1291 that "an outstanding attorneys' fees issue does not preclude an otherwise final decision from being a 'final decision.' *Budinich*, 486 U.S. at 202."

Judge Rosenbaum's other reference was to *Ray Haluch Gravel Co. v. Cent. Pension Fund of Int'l Union of Operating Eng'rs and Emps.*, 571 U.S. 177 (2014), where she said the Supreme Court reaffirmed the *Budinich* principle in a contractual context. In *Ray Haluch*, she described the Supreme Court as holding "that an unresolved attorneys' fee issue did not prevent a decision from being 'final' even though attorneys' fees were part of the contract damages to be awarded. *Id.* at 184–85."

"But this is a contempt case," Judge Rosenbaum said. She cited Eleventh Circuit authority as recently as 2019 for the proposition "that a contempt decision does not become 'final' until the contempt penalties imposed are no longer 'conditional or subject to modification.' *PlayNation Play Sys., Inc. v. Velex Corp.*, 939 F.3d 1205, 1212 (11th Cir. 2019) (citations omitted)."

According to Judge Rosenbaum, *PlayNation* and cases like it in the Eleventh Circuit, such as *Combs v. Ryan's Coal Co., Inc.*, 785 F.2d 970 (11th Cir. 1986),

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were based on Fox v. Capital Co., 299 U.S. 105 (1936).

Judge Rosenbaum was obliged to deal with the question of whether *Combs* and *PlayNation* were not good law in view of Supreme Court edicts in *Budinich* and *Ray Haluch*. She cited the familiar proposition that a circuit court must follow its own precedent, like *PlayNation*, unless the *en banc* court or the Supreme Court abrogates it. "Here," the judge said, "we issued *PlayNation* after the Supreme Court issued its decisions in *Budinich* and *Ray Haluch*. That means *PlayNation* controls."

Judge Rosenbaum said that *PlayNation* was "materially indistinguishable" from the case on appeal and required reversal of the district court, because the contempt order did not become final until the amount of attorneys' fees was fixed. She vacated the district court decision and remanded, presumably for the district court to consider whether *Taggart* precluded a contempt finding.

Observations

There is a lack of clarity as to whether a contempt order is final before the bankruptcy court determines the amount of damages and attorneys' fees. Courts typically seem to believe that attorneys' fees are integral and not subsidiary to the contempt claim, meaning there is no final order until attorneys' fees are fixed.

The Supreme Court's decision in *Bullard v. Blue Hills Bank*, 575 U.S. 496 (2015), does not answer the question definitively. In *Bullard*, the Court held that an order denying confirmation of a chapter 13 plan was not final and not appealable. *Bullard* instructs courts to identify the "relevant proceeding."

In the context of a bankruptcy proceeding for contempt, what's the relevant proceeding? Is it purely the finding of contempt, or is contempt inextricably bound with the debtor's damages and attorneys' fees? And what if the court fixes the debtor's damage but does not immediately rule on attorneys' fees?

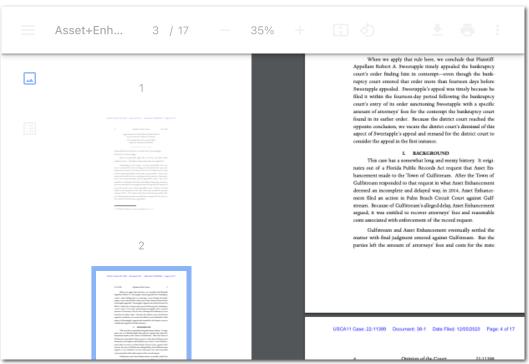
One day, an appellate court in a bankruptcy case may cite *Budinich* and *Ray Haluch* to hold that a contempt finding unadorned by attorneys' fees is final.

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Caution therefore counsels the filing of an appeal immediately after a finding of contempt. Courts could clarify finality by entering a memorandum opinion that finds contempt but withholding entry of an order until fixing the amount of damages and attorneys' fees.

Opinion Link

PREVIEW



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Case Details

Case Citation Sweetapple v. Asset

Enhancement Inc. (In re

Asset Enhancement

Inc.), 22-11389 (11th

Cir. Dec. 5. 2023)

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Case Name Sweetapple v. Asset

Enhancement Inc. (In re Asset Enhancement

Inc.)

Case Type <u>Business</u>

Court 11th Circuit

Bankruptcy Tags <u>Automatic Stay</u> <u>Bankruptcy Litigation</u>

Practice and Procedure Business Reorganization

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[+] FEEDBACK

Bartenwerfer v. Buckley, 598 U.S. 69 (2023)

143 S.Ct. 665, 214 L.Ed.2d 434, 72 Bankr.Ct.Dec. 71, 23 Cal. Daily Op. Serv. 1630...

KeyCite Yellow Flag - Negative Treatment
Distinguished by In re Uhls, Bankr.S.D.Ill., June 29, 2023
143 S.Ct. 665

Supreme Court of the United States.

Kate Marie BARTENWERFER, Petitioner

v. Kieran BUCKLEY

No. 21-908 | Argued December 6, 2022 | Decided February 22, 2023

Synopsis

Background: Judgment creditor filed adversary complaint, seeking determination that debt was excepted from discharge because Chapter 7 debtors fraudulently concealed material defects plaguing renovated house that they sold to him prepetition. Following bench trial, the United States Bankruptcy Court for the Northern District of California, Hannah L. Blumenstiel, J., 549 B.R. 222, ruled that debt was nondischargeable, and appeals were taken. The Bankruptcy Appellate Panel, 2017 WL 6553392, affirmed judgment as to debtor-husband, but vacated and remanded as to debtor-wife. On remand, after a second bench trial, the Bankruptcy Court, Blumenstiel, J., 596 B.R. 675, entered judgment in favor of debtor-wife. Judgment creditor appealed. The Bankruptcy Appellate Panel, 2020 WL 1970506, affirmed. Cross-appeals were taken. The United States Court of Appeals for the Ninth Circuit, 860 Fed.Appx. 544, reversed in relevant part and remanded with instructions. Certiorari was granted.

[Holding:] In a unanimous opinion, the Supreme Court, Justice Barrett, held that the subject debt, which arose from sale proceeds obtained by debtor-husband's fraudulent misrepresentations in selling to judgment creditor a house that debtors had remodeled as business partners, was a debt for money obtained by false pretenses, a false representation, or actual fraud within the meaning of the discharge exception, and so debtor-wife was precluded from discharging her liability for it, regardless of her own culpability, abrogating *Sullivan v. Glenn*, 782 F.3d 378, and *Matter of Walker*, 726 F.2d 452.

Affirmed.

Justice Sotomayor filed a concurring opinion in which Justice Jackson joined.

West Headnotes (22)

[1] Bankruptcy Debts and Liabilities Discharged

The Bankruptcy Code strikes a balance between the interests of insolvent debtors and their creditors, generally allowing debtors to discharge all pre-bankruptcy liabilities, but making exceptions when, in Congress's judgment, the creditor's interest in recovering a particular debt outweighs the debtor's interest in a fresh start.

3 Cases that cite this headnote

[2] Bankruptcy 🤛 Fraud

Written in the passive voice, the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud turns on how the money was obtained, not who committed fraud to obtain it. 11 U.S.C.A. § 523(a)(2)(A).

7 Cases that cite this headnote

[3] Bankruptcy 🧽 Discharge

Chapter 7 bankruptcy allows debtors to get a "fresh start" by discharging their debts.

4 Cases that cite this headnote

[4] Bankruptcy Debts and Liabilities Discharged

Not all debts are dischargeable in Chapter 7; the Bankruptcy Code makes several exceptions to the general rule of dischargeability. 11 U.S.C.A. § 523(a).

2 Cases that cite this headnote

Bartenwerfer v. Buckley, 598 U.S. 69 (2023)

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[5] Statutes 🕪 Language

In cases involving statutory interpretation, the Supreme Court begins its analysis with the text of the statute.

2 Cases that cite this headnote

[6] Bankruptcy Fraud committed by agent or one other than debtor

Debt owed by Chapter 7 debtors to judgment creditor, which arose from sale proceeds obtained by debtor-husband's fraudulent misrepresentations in failing to disclose material defects in house that debtors, as business partners, had renovated and sold to judgment creditor, was a debt for money obtained by false pretenses, a false representation, or actual fraud within the meaning of the discharge exception, and so debtor-wife was precluded from discharging her liability for the debt, regardless of her own culpability; abrogating *Sullivan v. Glenn*, 782 F.3d 378, and *Matter of Walker*, 726 F.2d 452. 11 U.S.C.A. § 523(a)(2) (A).

5 Cases that cite this headnote

[7] **Bankruptcy** Fraud committed by agent or one other than debtor

Congress framed the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, which is written in the passive voice, to focus on an event that occurs without respect to a specific actor, and therefore without respect to any actor's intent or culpability; the debt must result from someone's fraud, but Congress was "agnostic" about who committed it. 11 U.S.C.A. § 523(a)(2)(A).

3 Cases that cite this headnote

[8] Statutes - Tense, mood, and voice

In construing a statute, context may confine a passive-voice sentence to a likely set of actors.

3 Cases that cite this headnote

[9] Fraud Persons liable

The common law of fraud has long maintained that fraud liability is not limited to the wrongdoer, holding, for example, principals liable for the frauds of their agents, and individuals liable for frauds committed by their partners within the scope of the partnership.

2 Cases that cite this headnote

[10] Bankruptcy Poebts and Liabilities Discharged

Although the exceptions to discharge set forth in the Bankruptcy Code should be confined to those plainly expressed, this means that exceptions should not extend beyond their stated terms; the principle may not be used to artificially narrow ordinary meaning. 11 U.S.C.A. § 523(a).

3 Cases that cite this headnote

[11] Statutes 🕪 Context

Statutes Express mention and implied exclusion; expressio unius est exclusio alterius

Rule, that when Congress includes particular language in one section of a statute but omits it in another section of the same act, courts generally take the choice to be deliberate, is not absolute; context counts, and it may be difficult to read much into the absence of a word that is present elsewhere in a statute.

2 Cases that cite this headnote

[12] Statutes Prior or existing law in general

The Supreme Court generally assumes that, when Congress enacts statutes, it is aware of the Court's relevant precedents.

1 Case that cites this headnote

[13] Bankruptcy — Construction and Operation

The Bankruptcy Code is not focused on the unadulterated pursuit of the debtor's interest, but, like all statutes, balances multiple, often competing interests.

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3 Cases that cite this headnote

[14] Constitutional Law 🕪 Policy

Statutes Policy behind or supporting statute

No statute pursues a single policy at all costs, and courts are not free to rewrite a statute as if it did.

3 Cases that cite this headnote

[15] Bankruptcy Fraud committed by agent or one other than debtor

The Bankruptcy Code's discharge exception for debts obtained by false pretenses, a false representation, or actual fraud does not define the scope of one person's liability for another's fraud; that is the function of the underlying law, and the Code simply takes the debt as it finds it. 11 U.S.C.A. § 523(a)(2)(A).

3 Cases that cite this headnote

[16] Fraud Persons liable

Fraud Pefenses

Under the law of fraud, a faultless individual is ordinarily responsible for another's debt only when the two have a special relationship, and even then, defenses to liability are available.

[17] Labor and Employment Scope of Employment

Although an employer is generally accountable for the wrongdoing of an employee, he usually can escape liability if he proves that the employee's action was committed outside the scope of employment. Restatement (Third) of Agency § 7.07 (2006).

[18] Partnership 🤛 Torts

If one partner takes a wrongful act without authority or outside the ordinary course of business, then the partnership, and by extension, the innocent partners, are generally not on the hook. Uniform Partnership Act § 305.

1 Case that cites this headnote

[19] Corporations and Business

Organizations In general; nature and status

Partnership ← Nature and Characteristics in General

Partnership > Nature and characteristics

Partnerships and other businesses may organize as limited-liability entities, which insulate individuals from personal exposure to the business's debts. Uniform Partnership Act § 306(c); Uniform Limited Partnership Act § 303(a); Uniform Limited Liability Company Act § 304(a).

[20] Guaranty Fraud, duress, and undue influence

Principal and Surety 🗪 Fraud

If a surety or guarantor is duped into assuming secondary liability, then his obligation is typically voidable. Restatement (Third) of Suretyship & Guaranty § 12.

[21] Real Property Conveyances ← Right to Rescind

If a purchaser unwittingly contracts for fraudulently obtained property, he may be able to rescind the agreement.

[22] Bankruptcy Fraud committed by agent or one other than debtor

Innocent people are sometimes held liable for fraud they did not personally commit, and, if they declare bankruptcy, the Bankruptcy Code's discharge exception for debts obtained by false pretenses, a false representation, or actual fraud bars discharge of that debt. 11 U.S.C.A. § 523(a) (2)(A).

6 Cases that cite this headnote

Bartenwerfer v. Buckley, 598 U.S. 69 (2023)

143 S.Ct. 665, 214 L.Ed.2d 434, 72 Bankr.Ct.Dec. 71, 23 Cal. Daily Op. Serv. 1630...

****667** Syllabus*

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.

Kate and David Bartenwerfer decided to remodel the house they jointly owned in San Francisco and to sell it for a profit. David took charge of the project, while Kate remained largely uninvolved. They eventually sold the house to respondent Kieran Buckley. In conjunction with the sale, Kate and David attested that they had disclosed all material facts related to the property. After the purchase, Buckley discovered several defects that the Bartenwerfers had failed to disclose. Buckley sued in California state court and won, leaving the Bartenwerfers jointly responsible for more than \$200,000 in damages. Unable to pay that judgment or their other creditors, the Bartenwerfers filed for Chapter 7 bankruptcy. Buckley then filed an adversary complaint in the bankruptcy proceeding, alleging that the debt owed him on the state-court judgment was nondischargeable under the Bankruptcy Code's exception to discharge of "any debt ... for money ... to the extent obtained by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A). The Bankruptcy Court found that David had committed fraud and imputed his fraudulent intent to Kate because the two had formed a legal partnership to renovate and sell the property. The Bankruptcy Appellate Panel disagreed as to Kate's culpability, holding that § 523(a)(2)(A) barred her from discharging the debt only if she knew or had reason to know of David's fraud. On remand, the Bankruptcy Court determined that Kate lacked such knowledge and could therefore discharge her debt to Buckley. The Bankruptcy Appellate Panel affirmed. The Ninth Circuit reversed in relevant part. Invoking Strang v. Bradner, 114 U.S. 555, 5 S.Ct. 1038, 29 L.Ed. 248, the court held that a debtor who is liable for her partner's fraud cannot discharge that debt in bankruptcy, regardless of her own culpability.

Held: Section 523(a)(2)(A) precludes Kate Bartenwerfer from discharging in bankruptcy a debt obtained by fraud, regardless of her own culpability. Pp. 671 - 676.

(a) Kate (hereinafter, Bartenwerfer) disputes a straightforward reading of § 523(a)(2)(A)'s text. Bartenwerfer argues that an ordinary English speaker would understand that "money obtained by fraud" means money

obtained by the individual debtor's fraud. This Court disagrees. The passive voice in § 523(a)(2)(A) does not hide the relevant actor in plain sight, as Bartenwerfer suggests it removes the actor altogether. Congress framed § 523(a)(2) (A) to "focu[s] on an event that occurs without respect to a specific actor, and therefore without respect to any actor's intent or culpability." Dean v. United States, 556 U.S. 568, 572, 129 S.Ct. 1849, 173 L.Ed.2d 785. It is true that context can confine a passive-voice sentence to a likely set of actors. See, e.g., E. I. du Pont de Nemours & Co. v. Train, 430 U.S. 112, 128-129, 97 S.Ct. 965, 51 L.Ed.2d 204. But the legal context relevant to § 523(a)(2)(A)—the common law of fraud—has long maintained that fraud liability is not limited to the wrongdoer. Understanding § 523(a)(2)(A) to reflect "agnosticism" as to the identity of the wrongdoer is consistent with the age-old rule of fraud liability.

Bartenwerfer points out that "'exceptions to discharge should be confined to those plainly expressed.'" *Bullock v. BankChampaign, N. A.*, 569 U.S. 267, 275, 133 S.Ct. 1754, 185 L.Ed.2d 922. The Court, however, has never used this principle to artificially narrow ordinary meaning, invoking it instead to stress that exceptions should not extend beyond their stated terms. See, *e.g., Gleason v. Thaw*, 236 U.S. 558, 559–562, 35 S.Ct. 287, 59 L.Ed. 717.

Bartenwerfer also seeks support from § 523(a)(2)(A)'s neighboring provisions in subparagraphs (B) and (C), both of which require some culpable action by the debtor herself. Bartenwerfer claims that these neighboring provisions make explicit what is unstated in (A). This argument turns on its head the rule that " '[w]hen Congress includes particular language in one section ... but omits it in another section of the same Act,' " the Court generally takes "the choice to be deliberate." Badgerow v. Walters, 596 U. S. — 142 S.Ct. 1310, 212 L.Ed.2d 355. If there is an inference to be drawn here, the more likely one is that (A) excludes debtor culpability from consideration given that (B) and (C) expressly hinge on it. Bartenwerfer suggests it would defy credulity to think that Congress would bar debtors from discharging liability for fraud they did not personally commit under (A) while allowing debtors to discharge debt for (potentially more serious) fraudulent statements they did not personally make under (B). But the Court offered a possible answer for this disparity in Field v. Mans, 516 U.S. 59, 76-77, 116 S.Ct. 437, 133 L.Ed.2d 351. Whatever the rationale, it does not defy credulity to think that Congress established differing rules for (A) and (B). Pp. 671 - 674.

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(b) Any remaining doubt about the textual analysis is eliminated by this Court's precedent and Congress's response to it. In Strang v. Bradner, 114 U.S. 555, 5 S.Ct. 1038, 29 L.Ed. 248, the Court held that the fraud of one partner should be imputed to the other partners, who "received and appropriated the fruits of the fraudulent conduct." Id., at 561, 5 S.Ct. 1038. The Court so held despite the fact that the relevant 19th-century discharge exception for fraud disallowed the discharge of debts "created by the fraud or embezzlement of the bankrupt." 14 Stat. 533 (emphasis added). And when Congress next overhauled bankruptcy law, it deleted the phrase "of the bankrupt" from the discharge exception for fraud. The unmistakable implication is that Congress embraced Strang's holding. See Ysleta Del Sur Pueblo v. Texas, 596 U. S. —, —, 142 S.Ct. 1929, 213 L.Ed.2d 221. Pp. 673 - 675.

(c) Finally, Bartenwerfer insists that the preclusion of faultless debtors from discharging liabilities run up by their associates is inconsistent with bankruptcy law's "fresh start" policy. But the Bankruptcy Code is not focused on the unadulterated pursuit of the debtor's interest, and instead seeks to balance multiple, often competing interests. Bartenwerfer's fairness-based critiques also miss the fact that § 523(a)(2)(A) does not define the scope of one's liability for another's fraud. Section 523(a)(2)(A) takes the debt as it finds it, so if California did not extend liability to honest partners, § 523(a)(2)(A) would have no role here. And while Bartenwerfer paints a picture of liability being imposed on hapless bystanders, fraud liability generally requires a special relationship to the wrongdoer and, even then, defenses to liability are available. Pp. 675 - 676.

860 Fed.Appx. 544, affirmed.

BARRETT, J., filed an opinion for a unanimous Court. SOTOMAYOR, J., filed a concurring opinion, in which JACKSON, J., joined.

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Opinion

Justice BARRETT delivered the opinion of the Court.

**670 *72 [1] [2] The Bankruptcy Code strikes a balance between the interests of insolvent debtors and their creditors. It generally allows debtors to discharge all prebankruptcy liabilities, but it makes exceptions when, in Congress's judgment, the creditor's interest in recovering a particular debt outweighs the debtor's interest in a fresh start. One such exception bars debtors from discharging any debt for money "obtained by ... fraud." 11 U.S.C. § 523(a)(2)(A). The provision obviously applies to a debtor who was the fraudster. But sometimes a debtor is liable for fraud that she did not personally commit—for example, deceit practiced by a partner or an agent. We must decide whether the bar extends to this situation too. It does. Written in the passive voice, § 523(a)(2)(A) turns on how the money was obtained, not who committed fraud to obtain it.

Ι

In 2005, Kate Bartenwerfer and her then-boyfriend, David Bartenwerfer, jointly purchased a house in San Francisco. Acting as business partners, the pair decided to remodel the house and sell it at a profit. David took charge of the project. He hired an architect, structural engineer, designer, and general contractor; he monitored their work, reviewed invoices, and signed checks. Kate, on the other hand, was largely uninvolved.

Like many home renovations, the Bartenwerfers' project was bumpier than anticipated. Still, they managed to get the house on the market, and Kieran Buckley bought it. In conjunction with the sale, the Bartenwerfers attested that they had disclosed all material facts relating to the property. Yet after the house was his, Buckley discovered several defects that the Bartenwerfers had not divulged: a leaky roof, defective windows, a missing fire escape, and permit

1

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problems. Alleging that he had overpaid in reliance on the Bartenwerfers' misrepresentations, Buckley sued them in California *73 state court. The jury found in Buckley's favor on his claims for breach of contract, negligence, and nondisclosure of material facts, leaving the Bartenwerfers jointly responsible for more than \$200,000 in damages.

[3] [4] The Bartenwerfers were unable to pay Buckley, not to mention their other creditors. Seeking relief, they filed for Chapter 7 bankruptcy, which allows debtors to get a "fresh start" by discharging their debts. *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). While that sounds like complete relief, there is a catch—not all debts are dischargeable. The Code makes several exceptions to the general rule, including the one at issue in this case: Section 523(a)(2)(A) bars the discharge of "any debt ... for money ... to the extent obtained by ... false pretenses, a false representation, or actual fraud."

**671 Buckley filed an adversary complaint alleging that the money owed on the state-court judgment fell within this exception. After a 2-day bench trial, the Bankruptcy Court decided that neither David nor Kate Bartenwerfer could discharge their debt to Buckley. Based on testimony from the parties, real-estate agents, and contractors, the court found that David had knowingly concealed the house's defects from Buckley. And the court imputed David's fraudulent intent to Kate because the two had formed a legal partnership to execute the renovation and resale project.

The Ninth Circuit's Bankruptcy Appellate Panel agreed as to David's fraudulent intent but disagreed as to Kate's. As the panel saw it, § 523(a)(2)(A) barred her from discharging the debt only if she knew or had reason to know of David's fraud. It instructed the Bankruptcy Court to apply that standard on remand, and, after a second bench trial, the court concluded that Kate lacked the requisite knowledge of David's fraud and could therefore discharge her liability to Buckley. This time, the Bankruptcy Appellate Panel affirmed the judgment.

*74 The Ninth Circuit reversed in relevant part. *In re Bartenwerfer*, 860 Fed.Appx. 544 (2021). Invoking our decision in *Strang v. Bradner*, 114 U.S. 555, 5 S.Ct. 1038, 29 L.Ed. 248 (1885), it held that a debtor who is liable for her partner's fraud cannot discharge that debt in bankruptcy, regardless of her own culpability. 860 Fed.Appx. at 546. Kate thus remained on the hook for her debt to Buckley. *Id.*, at 546–547. We granted certiorari to resolve confusion in the lower

courts on the meaning of § 523(a)(2)(A). 596 U. S. ——, 142 S.Ct. 2675, 212 L.Ed.2d 761 (2022).

See, e.g., In re M.M. Winkler & Assoc., 239 F.3d 746, 749 (CA5 2001) (debts that arise from fraud cannot be discharged); In re Ledford, 970 F.2d 1556, 1561 (CA6 1992) (no discharge if the debtor benefited from the fraud); Sullivan v. Glenn, 782 F.3d 378, 381 (CA7 2015) (a debt is nondischargeable only if the debtor knew or should have known of the fraud); In re Walker, 726 F.2d 452, 454 (CA8 1984) (same); In re Villa, 261 F.3d 1148, 1151 (CA11 2001) (a debt cannot be discharged when fraud is imputed to the debtor under agency principles).

Π

Α

[5] [6] "[W]e start where we always do: with the text of the statute." *Van Buren* v. *United States*, 593 U. S. ——, ——, 141 S.Ct. 1648, 1654, 210 L.Ed.2d 26 (2021). Section 523(a) (2)(A) states:

"A discharge under section 727 ... of this title does not discharge an individual debtor from any debt ...

"(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by

"(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition."

By its terms, this text precludes Kate Bartenwerfer from discharging her liability for the state-court judgment. (From now on, we will refer to Kate as "Bartenwerfer.") First, she is an "individual debtor." Second, the judgment *75 is a "debt." And third, because the debt arises from the sale proceeds obtained by David's fraudulent misrepresentations, it is a debt "for money ... obtained by ... false pretenses, a false representation, or actual fraud."

Bartenwerfer disputes the third premise. She admits that, as a grammatical matter, the passive-voice statute does not specify a fraudulent actor. But in her view, the statute is most naturally read to bar the discharge of debts for money obtained **672 by *the debtor's* fraud.² To illustrate, she offers the sentence "Jane's clerkship was obtained through hard work." According to Bartenwerfer, an ordinary English

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speaker would understand this sentence to mean that *Jane's* hard work led to her clerkship. Brief for Petitioner 20. Section 523(a)(2)(A) supposedly operates the same way: An ordinary English speaker would understand that "money obtained by fraud" means money obtained by the *individual debtor's* fraud. Passive voice hides the relevant actor in plain sight.

Buckley contends that Bartenwerfer has forfeited this argument because in her petition for a writ of certiorari and in the lower courts, she asserted that § 523(a)(2)(A) bars discharge when the debtor "knew or should have known" of her partner's fraud. We disagree. The question presented is whether a debtor can be "subject to liability for the fraud of another that is barred from discharge in bankruptcy ... without any act, omission, intent or knowledge of her own." Pet. for Cert. i. Bartenwerfer's current argument—that the debt must arise from the debtor's own fraud—is "fairly included" within that question and her position in the lower courts. Supreme Court Rule 14.1(a); *Yee v. Escondido*, 503 U.S. 519, 534, 112 S.Ct. 1522, 118 L.Ed.2d 153 (1992).

[7] We disagree: Passive voice pulls the actor off the stage. At least on its face, Bartenwerfer's sentence conveys only that someone's hard work led to Jane's clerkship-whether that be Jane herself, the professor who wrote a last-minute letter of recommendation, or the counselor who collated the application materials. Section 523(a)(2)(A) is similarly broad. Congress framed it to "focu[s] on an event that occurs without respect to a specific actor, and therefore without *76 respect to any actor's intent or culpability." Dean v. United States, 556 U.S. 568, 572, 129 S.Ct. 1849, 173 L.Ed.2d 785 (2009); B. Garner, Modern English Usage 676 (4th ed. 2016) (the passive voice signifies that "the actor is unimportant" or "unknown"). The debt must result from someone's fraud, but Congress was "agnosti[c]" about who committed it. Watson v. United States, 552 U.S. 74, 81, 128 S.Ct. 579, 169 L.Ed.2d 472 (2007).

[8] [9] It is true, of course, that context can confine a passive-voice sentence to a likely set of actors. *E. I. du Pont de Nemours & Co. v. Train*, 430 U.S. 112, 128–129, 97 S.Ct. 965, 51 L.Ed.2d 204 (1977). If the dean of the law school delivers Bartenwerfer's hypothetical statement to Jane's parents, the most natural implication is that Jane's hard work led to the clerkship. But in the fraud-discharge exception, context does not single out the wrongdoer as the relevant actor. Quite the opposite: The relevant legal context—the common law of fraud—has long maintained that fraud liability is *not* limited to the wrongdoer. *Field v. Mans*, 516 U.S. 59, 70–75, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995) (interpreting § 523(a)

(2)(A) with reference to the common law of fraud). For instance, courts have traditionally held principals liable for the frauds of their agents. McCord v. Western Union Telegraph Co., 39 Minn. 181, 185, 39 N.W. 315, 317 (1888); Tome v. Parkersburg Branch R. Co., 39 Md. 36, 70-71 (1873); White v. Sawyer, 82 Mass. 586, 589 (1860); J. Story, Commentaries on the Law of Agency 465-467 (1839). They have also held individuals liable for the frauds committed by their partners within the scope of the partnership. Tucker v. Cole, 54 Wis. 539, 540–541, 11 N.W. 703, 703–704 (1882); Alexander v. State, 56 Ga. 478, 491-493 (1876); Chester v. Dickerson, 54 N.Y. 1, 11 (1873); J. Story, Commentaries on the Law of Partnership 161, 257–259 (1841). Understanding § 523(a)(2) (A) to reflect the passive voice's usual "agnosticism" is thus consistent with the age-old rule that individual debtors can **673 be liable for fraudulent schemes they did not devise.

*77 [10] Searching for a way to defeat the natural breadth of the passive voice, Bartenwerfer points to our observation that " 'exceptions to discharge "should be confined to those plainly expressed." ' " Bullock v. BankChampaign, N. A., 569 U.S. 267, 275, 133 S.Ct. 1754, 185 L.Ed.2d 922 (2013) (quoting Kawaauhau v. Geiger, 523 U.S. 57, 62, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998)). This does not get her far. We have never used this principle to artificially narrow ordinary meaning, which is what Bartenwerfer asks us to do. Instead, we have invoked it to stress that exceptions should not extend beyond their stated terms. In Gleason v. Thaw, we held that "liabilities for obtaining property" did not include an attorney's services because services are not property. 236 U.S. 558, 559-562, 35 S.Ct. 287, 59 L.Ed. 717 (1915). In Kawaauhau, we concluded that medical malpractice attributable to negligence or recklessness did not amount to a "willful and malicious injury." 523 U.S. at 59, 118 S.Ct. 974. And in Bullock, interpreting the discharge exception "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny," we applied the familiar noscitur a sociis canon to hold that the term "defalcation" possessed a mens rea requirement akin to those of "fraud," "embezzlement," and "larceny." 569 U.S. at 269, 274-275, 133 S.Ct. 1754. In each case, we reached a result that was "plainly expressed" by the text and ordinary tools of interpretation. Our interpretation in this case, which rests on basic tenets of grammar, is more of the same.

Bartenwerfer also seeks support from § 523(a)(2)(A)'s neighboring provisions, which both require action by the debtor herself. Section 523(a)(2)(B) bars the discharge of debts arising from the "use of a statement in writing—

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(i) that is materially false; (ii) respecting the debtor's or an insider's financial condition; (iii) on which the creditor to whom the debtor is liable ... reasonably relied; and (iv) that the debtor caused to be made or published with intent to deceive." (Emphasis added.) Similarly, § 523(a)(2)(C) presumptively bars the discharge of recently acquired "consumer *78 debts owed to a single creditor and aggregating more than \$500 for luxury goods or services incurred by an individual debtor" and "cash advances aggregating more than \$750 ... obtained by an individual debtor." § 523(a)(2)(C)(i) (emphasis added). Unlike subparagraph (A), the discharge exceptions in subparagraphs (B) and (C) expressly require some culpable act on the part of the debtor. According to Bartenwerfer, these provisions make explicit what goes without saying in (A): The debtor's own fraud must have given rise to the debt.

[11] This argument flips the rule that " [w]hen Congress includes particular language in one section of a statute but omits it in another section of the same Act," we generally take the choice to be deliberate." *Badgerow* v. *Walters*, 596 U. S. —, —, 142 S.Ct. 1310, 1318, 212 L.Ed.2d 355 (2022) (quoting *Collins* v. *Yellen*, 594 U. S. —, —, 141 S.Ct. 1761, 1782, 210 L.Ed.2d 432 (2021)). As the word "generally" indicates, this rule is not absolute. Context counts, and it is sometimes difficult to read much into the absence of a word that is present elsewhere in a statute. See, *e.g.*, *Field*, 516 U.S. at 67–69, 116 S.Ct. 437. But if there is an inference to be drawn here, it is not the one that Bartenwerfer suggests. The more likely inference is that (A) excludes debtor culpability from consideration given that (B) and (C) expressly hinge on it.

Bartenwerfer retorts that it would have made no sense for Congress to set up such a dichotomy, particularly between (A) and **674 (B). These two provisions are linked: (A) carves out fraudulent "statement[s] respecting the debtor's or an insider's financial condition," while (B) governs such statements that are reduced to writing. In Bartenwerfer's view, it "defies credulity" to think that Congress would bar debtors from discharging liability for mine-run fraud they did not personally commit while simultaneously allowing debtors to discharge liability for (potentially more serious) fraudulent statements they did not personally make. Brief for Petitioner 23.

*79 But in *Field*, we offered a possible answer for why (B) contains a more debtor-friendly discharge rule than (A): Congress may have "wanted to moderate the burden on

individuals who submitted false financial statements, not because lies about financial condition are less blameworthy than others, but because the relative equities might be affected by practices of consumer finance companies, which sometimes have encouraged such falsity by their borrowers for the very purpose of insulating their own claims from discharge." 516 U.S. at 76–77, 116 S.Ct. 437. This concern may also have informed Congress's decision to limit (B)'s prohibition on discharge to fraudulent conduct by the debtor herself. Whatever the rationale, it does not "def[y] credulity" to think that Congress established differing rules for (A) and (B). Brief for Petitioner 23.

В

Our precedent, along with Congress's response to it, eliminates any possible doubt about our textual analysis. In the late 19th century, the discharge exception for fraud read as follows: "[N]o debt created by the fraud or embezzlement of the bankrupt ... shall be discharged under this act." Act of Mar. 2, 1867, § 33, 14 Stat. 533 (emphasis added). This language seemed to limit the exception to fraud committed by the debtor herself—the position that Bartenwerfer advocates here.

But we held otherwise in *Strang* v. *Bradner*. In that case, the business partner of John and Joseph Holland lied to fellow merchants in order to secure promissory notes for the benefit of their partnership. 114 U.S. at 557-558, 5 S.Ct. 1038. After a state court held all three partners liable for fraud, the Hollands tried to discharge their debts in bankruptcy on the ground that their partner's misrepresentations "were not made by their direction nor with their knowledge." Id., at 557, 561, 5 S.Ct. 1038. Even though the statute required the debt to be created by the fraud "of the bankrupt," we held that the *80 Hollands could not discharge their debts to the deceived merchants. Id., at 561, 5 S.Ct. 1038. The fraud of one partner, we explained, is the fraud of all because "[e]ach partner was the agent and representative of the firm with reference to all business within the scope of the partnership." *Ibid*. And the reason for this rule was particularly easy to see because "the partners, who were not themselves guilty of wrong, received and appropriated the fruits of the fraudulent conduct of their associate in business." Ibid.

[12] The next development—Congress's post-*Strang* legislation—is the linchpin.³ "This Court generally assumes that, when Congress enacts statutes, it is **675 aware of this

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Court's relevant precedents." *Ysleta Del Sur Pueblo v. Texas*, 596 U. S. —, —, 142 S.Ct. 1929, 1940, 213 L.Ed.2d 221 (2022). Section 523(a)(2) is no exception to this interpretive rule. *Lamar, Archer & Cofrin, LLP v. Appling*, 584 U. S. —, — —, 138 S.Ct. 1752, 1761–1762, 201 L.Ed.2d 102 (2018). So if Congress had reenacted the discharge exception for fraud without change, we would assume that it meant to incorporate *Strang*'s interpretation. *Appling*, 584 U. S., at — —, 138 S.Ct., at 1761–1762; *Lorillard v. Pons*, 434 U.S. 575, 580, 98 S.Ct. 866, 55 L.Ed.2d 40 (1978).

Bartenwerfer asserts that we should ignore *Strang* because, as a product of the *Swift* v. *Tyson* era, it turned on the Court's understanding of the general common-law rule rather than its interpretation of the statutory text. 16 Pet. 1, 41 U.S. 1, 10 L.Ed. 865 (1842). This argument is a detour we need not take. Whatever *Strang*'s rationale, it constituted an important part of the background against which Congress drafted the current discharge exception for fraud.

But Congress went even further than mere reenactment. Thirteen years after *Strang*, when Congress next overhauled bankruptcy law, it deleted "of the bankrupt" from the discharge exception for fraud, which is the predecessor to the modern § 523(a)(2)(A). Act of July 1, 1898, § 17, 30 Stat. 550 ("A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as ... are judgments in actions for frauds, or obtaining property by false pretenses or false representations, or for willful and malicious *81 injuries to the person or property of another"). By doing so, Congress cut from the statute the strongest textual hook counseling against the outcome in *Strang*. The unmistakable implication is that Congress embraced *Strang*'s holding—so we do too.

C

In a last-ditch effort to persuade us, Bartenwerfer invokes the "fresh start" policy of modern bankruptcy law. Precluding faultless debtors from discharging liabilities run up by their associates, she says, is inconsistent with that policy, so § 523(a)(2)(A) cannot apply to her. A contrary holding would be a throwback to the harsh days when "debtors faced 'perpetual bondage to their creditors,' surviving on 'a miserable pittance [and] dependent upon the bounty or forbearance of [their] creditors.' " Brief for Petitioner 16 (quoting 3 J. Story, Commentaries on the Constitution of the United States 5 (1833)). The same Congress that

"champion[ed]" the fresh start could not also have shackled honest debtors with liability for frauds that they did not personally commit. Brief for Petitioner 37.

[13] [14] This argument earns credit for color but not much else. To begin, it characterizes the Bankruptcy Code as focused on the unadulterated pursuit of the debtor's interest. But the Code, like all statutes, balances multiple, often competing interests. Section 523 is a case in point: Barring certain debts from discharge necessarily reflects aims distinct from wiping the bankrupt's slate clean. Perhaps Congress concluded that these debts involved particularly deserving creditors, particularly undeserving debtors, or both. Regardless, if a fresh start were all that mattered, § 523 would not exist. No statute pursues a single policy at all costs, and we are not free to rewrite this statute (or any other) as if it did. *Azar* v. *Allina Health Services*, 587 U. S. ——, ——, 139 S.Ct. 1804, 1815, 204 L.Ed.2d 139 (2019).

[15] It also bears emphasis—because the thread is easily lost in Bartenwerfer's argument—that § 523(a)(2)(A) does not define *82 the scope of one person's liability for another's fraud. That is the function of the underlying law—here, the law of California. Section 523(a)(2)(A) takes the debt as it finds it, so if California did not extend liability to honest partners, § 523(a)(2)(A) would have no role to play. Bartenwerfer's fairness-based critiques seem better directed toward the state law that imposed the obligation on her in the first place.

[19] And while Bartenwerfer **676 [16] [17] [18] paints a picture of liability imposed willy-nilly on hapless bystanders, the law of fraud does not work that way. Ordinarily, a faultless individual is responsible for another's debt only when the two have a special relationship, and even then, defenses to liability are available. For instance, though an employer is generally accountable for the wrongdoing of an employee, he usually can escape liability if he proves that the employee's action was committed outside the scope of employment. Restatement (Third) of Agency § 7.07 (2006); D. Dobbs, P. Hayden, & E. Bublick, Law of Torts § 425 (2022). Similarly, if one partner takes a wrongful act without authority or outside the ordinary course of business, then the partnership—and by extension, the innocent partners—are generally not on the hook. Uniform Partnership Act § 305 (2013). Partnerships and other businesses can also organize as limited-liability entities, which insulate individuals from personal exposure to the business's debts. See, e.g., § 306(c) (limited-liability partnerships); Uniform Limited Partnership

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Act § 303(a) (2013) (limited partnerships); Uniform Limited Liability Company Act § 304(a) (2013) (limited-liability companies).

[20] [21] Individuals who themselves are victims of fraud are also likely to have defenses to liability. If a surety or guarantor is duped into assuming secondary liability, then his obligation is typically voidable. Law of Suretyship and Guaranty § 6:8 (2022); Restatement (Third) of Suretyship & Guaranty § 12 (1996). Likewise, if a purchaser unwittingly contracts for fraudulently obtained property, he may be able to rescind the agreement. *83 27 R. Lord, Williston on Contracts § 69:47 (4th ed. 2022). Thus, victims have a variety of antecedent defenses at their disposal that, if successful, protect them from acquiring any debt to discharge in a later bankruptcy proceeding.

[22] All of this said, innocent people are sometimes held liable for fraud they did not personally commit, and, if they declare bankruptcy, § 523(a)(2)(A) bars discharge of that debt. So it is for Bartenwerfer, and we are sensitive to the hardship she faces. But Congress has "evidently concluded that the creditors' interest in recovering full payment of debts" obtained by fraud "outweigh[s] the debtors' interest in a complete fresh start," *Grogan v. Garner*, 498 U.S. 279, 287, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991), and it is not our role to second-guess that judgment.

Ш

We affirm the Ninth Circuit's judgment that Kate Bartenwerfer's debt is not dischargeable in bankruptcy.

It is so ordered.

Justice SOTOMAYOR, with whom Justice JACKSON joins, concurring.

The Court correctly holds that 11 U.S.C. § 523(a)(2)(A) bars debtors from discharging a debt obtained by fraud of the debtor's agent or partner. Congress incorporated into the statute the common-law principles of fraud, *Husky Int'l Electronics, Inc. v. Ritz*, 578 U.S. 356, 360, 136 S.Ct. 1581, 194 L.Ed.2d 655 (2016) (citing *Field v. Mans*, 516 U.S. 59, 69, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995)), which include agency and partnership principles, *ante*, at 672 - 673. This Court long ago confirmed that reading when it held that fraudulent debts obtained by partners are not dischargeable, *Strang v. Bradner*, 114 U.S. 555, 559–561, 5 S.Ct. 1038, 29 L.Ed. 248 (1885), and Congress "embraced" that reading when it amended the statute in 1898, *ante*, at 675.

**677 The Bankruptcy Court found that petitioner and her husband had an agency relationship and obtained the debt at *84 issue after they formed a partnership. Because petitioner does not dispute that she and her husband acted as partners, the debt is not dischargeable under the statute.

The Court here does not confront a situation involving fraud by a person bearing no agency or partnership relationship to the debtor. Instead, "[t]he relevant legal context" concerns fraud only by "agents" and "partners within the scope of the partnership." *Ante*, at 672. With that understanding, I join the Court's opinion.

All Citations

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In re Bartenwerfer, 549 B.R. 222 (2016)

KeyCite Red Flag - Severe Negative Treatment
Affirmed in Part, Vacated in Part, Remanded by In re Bartenwerfer, 9th
Cir.BAP (Cal.), December 22, 2017

549 B.R. 222

United States Bankruptcy Court, N.D. California.

IN RE: David William BARTENWERFER and Kate Marie Bartenwerfer, Debtors.

Kieran Buckley, Plaintiff,

V

David William Bartenwerfer and Kate Marie Bartenwerfer. Defendants.

Case No. 13–30827 HLB | Adv. Proc. No. 13–03185 HLB |

Signed and Filed: April 1, 2016

Synopsis

Background: Judgment creditor filed adversary complaint, seeking determination that debt was excepted from discharge because debtors fraudulently omitted disclosing material defects plaguing real property that they sold to him prepetition. Trial was held.

Holdings: The Bankruptcy Court, Hannah L. Blumenstiel, J., held that:

- [1] under California law, collateral estoppel applied to the state-court jury verdict in favor of judgment creditor with respect to the misrepresentation, justifiable reliance, proximate cause, and damages elements of a cause of action under the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, and
- [2] judgment creditor established that debtors acted with the requisite knowledge and intent to deceive in failing to disclose issues relating to water leaks, window conditions, status of permits, and fire escape.

Debt held nondischargeable.

West Headnotes (14)

[1] Bankruptcy Fraud Bankruptcy Particular cases

To prevail in an action under the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, creditor must prove five elements by preponderance of the evidence: (1) a misrepresentation, fraudulent omission, or deceptive conduct by debtor, (2) knowledge of the falsity or deceptiveness of his statement or conduct, (3) debtor made the representation with the intention and purpose of deceiving creditor, (4) creditor justifiably relied on the representation, and (5) creditor sustained damage as the proximate result of the representation. 11 U.S.C.A. § 523(a)(2)(A).

[2] Res Judicata 🕪 Discharge

Principles of collateral estoppel apply to bankruptcy proceedings seeking exceptions from discharge. 11 U.S.C.A. § 523(a).

[3] Bankruptcy Application of state or federal law in general

Judgment 📻 Bankruptcy

Under the Full Faith and Credit Act, the preclusive effect of a state-court judgment in a subsequent bankruptcy proceeding is determined by the preclusion law of the state in which the judgment was issued. 28 U.S.C.A. § 1738.

[4] Res Judicata • Collateral estoppel and issue preclusion in general

Under California law, collateral estoppel may only be applied if its application furthers the public policies underlying the doctrine and if five threshold requirements are met: (1) the issue to be precluded from relitigation must be identical to that decided in a former proceeding, (2) the issue must have been actually litigated in the former proceeding, (3) the issue must have been

1

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necessarily decided in the former proceeding, (4) the decision in the former proceeding must have been final and on the merits, and (5) the party against whom preclusion is sought must be the same as, or in privity with, the party to the former proceeding.

[5] Res Judicata Purpose or function of doctrines

Under California law, the policies underlying the doctrine of collateral estoppel are preservation of the integrity of the judicial system, promotion of judicial economy, and protection of litigants from harassment by vexatious litigation.

[6] Res Judicata • Collateral estoppel and issue preclusion

Under California law, the party asserting collateral estoppel bears the burden of establishing its five threshold requirements.

[7] **Judgment** Sankruptcy

Under California law, prepetition state-court jury verdict against debtors was entitled to collateral estoppel effect in judgment creditor's subsequent proceeding under the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, with respect to the misrepresentation, justifiable reliance, proximate cause, and damages elements of that cause of action; jury found that debtors, in connection with the sale of their real property to judgment creditor, failed to disclose material information that they knew or should have known, that judgment creditor did not know nor could have known about the omitted information, and that the omission of material information was a substantial factor contributing to judgment creditor's harm, these issues were actually and necessarily litigated in the action, which involved same parties as nondischargeability proceeding, and principles underlying the doctrine were furthered by its application in this proceeding. 11 U.S.C.A. § 523(a)(2)(A).

[8] Bankruptcy 🕪 Intent or knowledge

Scienter requirement for a fraudulent misrepresentation is established by showing either actual knowledge of the falsity of a statement, or reckless disregard for its truth. 11 U.S.C.A. § 523(a)(2)(A).

[9] Bankruptcy 🤛 Intent

For nondischargeability purposes, debtor's intent to deceive or reckless disregard for the truth can be inferred from the totality of the circumstances. 11 U.S.C.A. § 523(a)(2)(A).

[10] Bankruptcy 🕪 Intent or knowledge

For nondischargeability purposes, a representation may be fraudulent, without knowledge of its falsity, if the person making it is conscious that he has merely a belief in its existence and recognizes that there is a chance, more or less great, that the fact may not be as it is represented. 11 U.S.C.A. § 523(a)(2)(A).

[11] Bankruptcy False pretenses; conduct, concealment, omission or silence; implied representations

Debtor's omission gives rise to liability for fraud only when there is a duty to disclose. 11 U.S.C.A. § 523(a)(2)(A).

[12] Bankruptcy False pretenses; conduct, concealment, omission or silence; implied representations

For nondischargeability purposes, a party to a business transaction has a duty to disclose when the other party is ignorant of material facts which he does not have an opportunity to discover. 11 U.S.C.A. § 523(a)(2)(A).

[13] Antitrust and Trade Regulation — Housing sales

California law requires a seller of real property to make certain disclosures of which the seller has knowledge at the time of the disclosure; these disclosures must be made in good faith, which requires honesty in fact in conducting the transaction. Cal. Civ. Code §§ 1102, 1102.7.

[14] Bankruptcy Fraud committed by agent or one other than debtor

Bankruptcy 🗪 Intent or knowledge

Debtors, in failing to disclose issues relating to water leaks, window conditions, status of permits, and fire escape, acted with requisite knowledge and intent to deceive for debt arising from their prepetition sale of real property to judgment creditor to fall within the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud; debtor-husband admitted that he understood that he had ongoing duty to disclose any material defects, that is, anything a buyer would want to know before purchasing the property, and that disclosures he made pursuant to California statute governing disclosures upon transfer of residential property constituted his representations as to condition of the property, these representations were attributable to debtorwife, as she signed them, and debtors failed to disclose recent leak in master bedroom ceiling, ten open permits and their expiration, windows that had been installed out-of-square, and missing fire escape. 11 U.S.C.A. § 523(a)(2) (A); Cal. Civ. Code § 1102.

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MEMORANDUM DECISION

HANNAH L. BLUMENSTIEL, U.S. Bankruptcy Judge

I. INTRODUCTION

This matter came on for trial on January 19 and 22, 2016 on Plaintiff Kieran Buckley's complaint to determine the dischargeability of debt pursuant to 11 U.S.C. § 523(a) (2)(A). The sole issue at trial was whether Defendants David and Kate Bartenwerfer fraudulently omitted disclosing material defects plaguing real property sold by the Bartenwerfers to Mr. Buckley.

Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, §§ 101–1532, or to the Federal Rules of Bankruptcy Procedure, Rules 1001–9036.

Janet Brayer and Stephen Finestone appeared for Mr. Buckley. Iain MacDonald and Matthew Olson appeared for the Bartenwerfers. After the parties rested, the Court took the matter under advisement.

This memorandum decision constitutes the Court's findings of fact and conclusions of law as required by Rule 52(a) of the Federal Rules of Civil Procedure, as made applicable to this adversary proceeding by Rule 7052 of the Federal Rules of Bankruptcy Procedure. This court has jurisdiction over this action under 28 U.S.C. § 1334(b). The parties have consented to entry of final judgment by this Court in this action, which is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I). Venue of this lawsuit is proper pursuant to 28 U.S.C. § 1409.

For the reasons that follow, the Court finds that the Bartenwerfers fraudulently omitted disclosing material defects on the subject property and that their related debt to Mr. Buckley is non-dischargeable pursuant to section 523(a) (2)(A).

II. BACKGROUND

Mr. Bartenwerfer received an MBA from Stanford in 1995. He has no education or training in construction and does not hold a contractor's license. Mrs. Bartenwerfer has worked at McKesson for 10 years and is currently employed as a Manager. She also holds a California real *225 estate agent's license. Schedule I.² The Bartenwerfers operate two businesses: RJUOP I, LLC, a property development business, and Parthenon Design. Statement of Financial Affairs no. 18.

The Court takes judicial notice of the documents filed in the underlying bankruptcy case (case no. 13–30827). Fed.R.Evid. 201 made applicable to bankruptcy proceedings pursuant to Fed. R. Bankr.Proc. 9017.

The Bartenwerfers bought and extensively remodeled a home located at 549 28th Street, San Francisco, California (the "Property"), which they subsequently sold to Mr. Buckley. The Bartenwerfers signed disclosure statements regarding the condition of the Property on November 11, 2007. They signed the sales contract on January 24, 2008. Escrow closed on March 14, 2008. Post-sale, Mr. Buckley discovered undisclosed defects and ultimately sued the Bartenwerfers in San Francisco County Superior Court to recoup damages under a number of theories. After a 19–day trial, a jury entered a special verdict. As relevant to this proceeding, the jury found in favor of Mr. Buckley on his claim for Non–Disclosure of Material Facts as follows:

- (1) The Bartenwerfers failed to disclose information that they knew or should have known about water leaks, window conditions, permits, and the fire escape.
- (2) Mr. Buckley did not know and could not have reasonably discovered this information.
- (3) The Bartenwerfers knew or reasonably should have known that Mr. Buckley did not know and could not have reasonably discovered the information.
- (4) This information significantly affected the value or desirability of the property.
- (5) Mr. Buckley was harmed.
- (6) The Bartenwerfers' failure to disclose the information was a substantial factor in causing Mr. Buckley's harm.

The state court entered a judgment against the Bartenwerfers in the amount of \$444,671. After post-trial briefing, Mr. Buckley accepted a \$210,000 reduction in the amount of the judgment, which was amended to award \$234,671.

Mr. Buckley requests a finding of non-dischargeability under section 523(a)(2)(A) as to the damages awarded by the state court for non-disclosure of issues relating to water leaks (\$48,981), window conditions (\$20,000), status of permits (\$14,888), and the fire escape (\$5,076); the value/cost differential (\$90,000); and costs of suit (\$40,019.89) for a total non-dischargeable debt in the amount of \$218,964.89.

The Bartenwerfers do not dispute the amount of damages, but assert that they did not possess the fraudulent intent necessary to except the judgment from discharge under section 523(a) (2)(A).³

3 The Defendants also argued in their trial brief that Mr. Bartenwerfer's alleged fraudulent conduct could not be imputed to Mrs. Bartenwerfer based on their marital relationship. At trial, after Mr. Buckley rested his casein-chief, the Bartenwerfers moved for a directed verdict pursuant to Federal Rule of Civil Procedure 52(c), applicable in this proceeding via Rule 7052, as to Mrs. Bartenwerfer, on the grounds that Mr. Buckley failed to prove by a preponderance of the evidence that she had the requisite knowledge of the misrepresentations and omissions or intent to defraud, and that a marital relationship is insufficient to impute the fraud of one spouse to the other. The Court denied the motion for a directed verdict, finding that an agency relationship existed between Mr. and Mrs. Bartenwerfer based on their partnership with respect to the remodel project: she was on title to the Property, signed the disclosure statements relating to the Property, and would financially benefit from the successful completion of the project and sale of the Property.

*226 III. LEGAL STANDARDS

A. Exception to Discharge under section 523(a)(2)

Section 523(a)(2)(A) provides: (a) A discharge under ... this title does not discharge an individual debtor from any debt—... (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by —(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition. 11 U.S.C. § 523(a)(2)(A).

[1] To prevail in a section 523(a)(2)(A) action, a creditor must prove five elements by preponderance of the evidence: (1) a misrepresentation, fraudulent omission or deceptive conduct by the debtor; (2) knowledge of the falsity or deceptiveness of his statement or conduct; (3) the debtor made the representation with the intention and purpose of deceiving the creditor; (4) the creditor justifiably relied on the representation; and (5) the creditor sustained damage as the proximate result of the representation. *Turtle Rock Meadows Homeowners Ass'n. v. Slyman (In re Slyman)*, 234 F.3d 1081, 1085 (9th Cir.2000).

B. Collateral Estoppel

[2] [3] Principles of collateral estoppel apply to proceedings seeking exceptions from discharge pursuant to 11 U.S.C. § 523(a). *Grogan v. Garner*, 498 U.S. 279, 284 n. 11, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). Under the Full Faith and Credit Act, 28 U.S.C. § 1738, the preclusive effect of a state court judgment in a subsequent bankruptcy proceeding is determined by the preclusion law of the state in which the judgment was issued. *Harmon v. Kobrin (In re Harmon)*, 250 F.3d 1240, 1245 (9th Cir.2001) (citations omitted). Thus, California law governs the preclusive effect of Mr. Buckley's judgment.

[4] [5] Under California law, collateral estoppel may only be applied if five threshold requirements are met and if its application furthers the public policies underlying the doctrine. *Id.* The policies the Court must consider are preservation of the integrity of the judicial system, promotion of judicial economy, and protection of litigants from harassment by vexatious litigation. *Lucido v. Superior Court*, 51 Cal.3d 335, 343, 795 P.2d 1223, 1227, 272 Cal.Rptr. 767 (1990).

[6] The five threshold requirements are: (1) the issue to be precluded from relitigation must be identical to that decided in a former proceeding; (2) the issue must have been actually litigated in the former proceeding; (3) the issue must have been necessarily decided in the former proceeding; (4) the decision in the former proceeding must have been final and on the merits; and (5) the party against whom preclusion is sought must be the same as, or in privity with, the party to the former proceeding. *Id.* The party asserting collateral estoppel bears the burden of establishing these requirements. *Id.*

IV. DISCUSSION

A. Collateral Estoppel Applies to the Jury Verdict

[7] The state court jury verdict on Mr. Buckley's cause of action for Seller Non–Disclosure of Material Facts found that the Bartenwerfers failed to disclose material information that they knew or should have known (misrepresentation); that Mr. Buckley did not know nor could have known about the omitted information (justifiable *227 reliance); and that the omission of material information was a substantial factor contributing to Mr. Buckley's harm (proximate cause and damages). Thus, these issues, which are identical to most of the elements Mr. Buckley would need to prove in order to prevail on his section 523(a)(2)(A) claim, were actually and necessarily litigated in the state court action, which involved

the same parties. No one disputes that the amended judgment is final.

But beyond this, the Court finds that the principles underlying the doctrine of collateral estoppel are furthered by its application here as to these findings which satisfy elements (1), (4), and (5) of a 523(a) action, as enumerated above. The issues have already been decided so it would not be judicially economical to retry them. Furthermore, retrying the issues in this Court could result in a different outcome, which would negatively impact the integrity of the judicial system.

As the Court previously found in the context of Plaintiff's motion for summary judgment, the remaining elements; i.e., knowledge of the falsity of the statement and intent to deceive the creditor, were not actually litigated or decided and were subject to a trial on the merits.

B. Knowledge and Intent

[8] [9] [10] The scienter requirement for a fraudulent misrepresentation is established by showing either actual knowledge of the falsity of a statement, or reckless disregard for its truth. *Gertsch v. Johnson & Johnson, Fin. Corp.* (*In re Gertsch*), 237 B.R. 160, 167 (9th Cir. B.A.P. 1999). Intent to deceive or reckless disregard for truth can be inferred from the totality of the circumstances. *Id.* at 167–68. "A representation may be fraudulent, without knowledge of its falsity, if the person making it 'is conscious that he has merely a belief in its existence and recognizes that there is a chance, more or less great, that the fact may not be as it is represented." " *Id.* at 168 (quoting Restatement (Second) of Torts § 526, cmt. E (1977)).

[11] [12] An omission gives rise to liability for fraud only when there is a duty to disclose. *Citibank, N.A. v. Eashai (In re Eashai)*, 87 F.3d 1082, 1089 (9th Cir.1996). "[A] party to a business transaction has a duty to disclose when the other party is ignorant of material facts which he does not have an opportunity to discover." *Apte v. Japra M.D., F.A.C.C., Inc. (In re Apte)*, 96 F.3d 1319, 1324 (9th Cir.1996).

[13] In addition, California law requires a seller of real property to make certain disclosures of which the seller has knowledge at the time of the disclosure. Cal. Civ.Code §§ 1102 et seq. These disclosures must be made in good faith, which requires honesty in fact in conducting the transaction. Cal. Civ.Code § 1102.7.

[14] At trial, Mr. Bartenwerfer admitted that he understood that the disclosures he made pursuant to California Civil Code section 1102 constituted his representations as to the condition of the Property. These representations belong to Mrs. Bartenwerfer, too, given that she signed them. The substance of these representations and the extent to which they did not accurately or completely disclose the Property's condition, merit further discussion.

On November 11, 2007, the Bartenwerfers signed a Real Estate Transfer Disclosure Statement (the "Disclosure Statement") certifying that the information therein was true and correct to the best of their knowledge as of that date. Plaintiff's Ex. 2 at 3.⁴ The Bartenwerfers also *228 signed a Seller's Supplemental to the Real Estate Transfer Disclosure Statement (the "Supplemental Disclosure" and, together with the Disclosure Statement, the "Disclosures") on November 11, 2007, stating that they answered the questions therein in "in an effort to fully disclose all material facts relating to the Property and hereby certify that the information provided is true and correct to the best of my knowledge." *Id.* at 7.

Mrs. Bartenwerfer is identified as "Kate Pfenninger," which the Court believes to be her maiden name.

On January 24, 2008, the Bartenwerfers signed a Contract for the Sale and Purchase of Real Property (the "Contract"), representing that "Seller has no knowledge or notice that the Property has any material defects other than as disclosed by the Seller in the [Disclosure Statement] or other writing before Acceptance or a soon thereafter as practicable." Plaintiff's Ex. 1 at 6, ¶ 19. The Bartenwerfers made no additional written disclosures beyond what was contained in the Disclosures and Contract. Mr. Bartenwerfer admitted that he understood that he had an ongoing duty to disclose to Mr. Buckley any material defects; i.e., anything a buyer would want to know before purchasing the Property.

1. Mr. Bartenwerfer's Credibility

At trial, in an apparent effort to try to protect Mrs. Bartenwerfer from having any findings of fraudulent intent imputed to her, Mr. Bartenwerfer testified that he did not prepare the Disclosure Statement on behalf of Mrs. Bartenwerfer. This testimony contradicted his testimony during the state court trial that he had prepared the Disclosure Statement on behalf of his wife. Reporter's Transcript of Trial Proceedings David Bartenwerfer's Testimony, September 5, 2012 at 94.

In addition, when asked whether Mrs. Bartenwerfer authorized him to complete the Supplemental Disclosure on her behalf, Mr. Bartenwerfer avoided answering the question directly, stating that she sat at the kitchen table while he filled it out but did not herself have the necessary information. This testimony was inconsistent with his testimony during the state court trial which explicitly acknowledged that Mrs. Bartenwerfer authorized him to complete the Supplemental Disclosure on her behalf. *Id.* at 111–12.

The Court finds that these inconsistent statements, as well as others made during trial, as noted below, significantly and negatively affect the credibility of Mr. Bartenwerfer's testimony

2. Water Leaks

The Bartenwerfers answered "No" to the question on the Supplemental Disclosure that asked: "Are there any past or present leaks or water intrusion from or through the roof, skylights, windows, siding, basement, foundation, or any other source? (please itemize even if leaks have been stopped)." *Id.* at 6.

At trial, Mr. Bartenwerfer admitted that he paid Freutel Roofing Inc. to repair leaks, specifically a leak above the master bedroom closet near the deck. Freutel Roofing submitted a quote for \$1,600 to do work including patching the membrane at the deck area, adding material to the upper roof to get better drainage, and replace and seal base at same area of roof. The quote is dated October 17, 2007, less than a month before the Bartenwerfers signed the Supplemental Disclosure, in which they represented that there were no past or present leaks. In 2008–2009, Mr. Buckley discovered a leak in the master bedroom ceiling, below the deck, as well as other leaks, including one in the media room.

*229 Mr. Bartenwerfer admitted that he did not amend the Disclosures to disclose the leak and testified that he did not believe he had to disclose the leak because it occurred during the construction process and was corrected before the construction was complete. Mr. Bartenwerfer admitted that he did not disclose the leak to his realtor, Peter Monti, because it "didn't feel like a big deal." Mr. Bartenwerfer denies any intent to deceive and asserts that he made a simple mistake. The Court does not find Mr. Bartenwerfer's testimony credible, especially in light of the fact that the leak was repaired so close in time to the Supplemental Disclosures and at the very end of the construction on the Property. Considering the totality of the circumstances, including those

relating to the other non-disclosures, the Court finds and concludes that the Bartenwerfers had the requisite knowledge and intent to deceive Mr. Buckley with respect to non-disclosure of the leak.

3. Permits

On the Supplemental Disclosure, the Bartenwerfers indicated that every time a permit for work on the Property was applied for, it was issued, but that an inspector did not approve the work by signing off on each permit after the relevant construction work was completed. Plaintiff's Ex. 2 at 6. The Bartenwerfers provided an explanation, stating that they let the "permit to update original kitchen [to] expire because of floorplan change, new kitchen completed with permits." *Id.* The Bartenwerfers did not disclose any additional open permits.

At trial, Mr. Bartenwerfer admitted that at the time he signed the Disclosures he was aware that electrical and plumbing work had not been approved by an inspector, that the permits had not received final sign off, and that a lack of final sign off on electrical and plumbing permits is something a buyer would want to know. Mr. Bartenwerfer admitted that as of November 11, 2007—the date the Bartenwerfers signed the Disclosures—there were ten permits which had not been signed off as complete. Mr. Bartenwerfer asserted that he did not disclose the open permits because he thought they were "basically done" and would be signed off at any time. But, Mr. Bartenwerfer also admitted that he was aware that the plumbing and electrical permits had not been signed off as final as of January 22, 2008, the date of Mr. Buckley's offer to buy the Property. Though more than two months had passed since they signed the Disclosures, the Bartenwerfers still did not disclose the open permits to Mr. Buckley.

Mr. Bartenwerfer admitted at trial that he received a Notice of Violation, dated January 31, 2008, which stated in relevant part that all permits had expired and no special inspection reports had been submitted (18 reports were required). He also admitted that he did not disclose the Notice of Violation or the expired permits to Mr. Buckley or Mr. Monti, and that he did not provide all permits to Mr. Buckley until after close of escrow. Mr. Monti testified that he had never seen the Notice of Violation and that such a notice would require the Disclosures to be amended. In his defense at trial, Mr. Bartenwerfer stated that the Notice of Violation was "an administrative issue" and that he did not think he had to disclose it. The Court finds that by the end of January 2008, Mr. Bartenwerfer was aware that the undisclosed open

permits had expired and still did not disclose them to Mr. Buckley.

On March 13, 2008, the day before escrow closed, Mr. Buckley's realtor, Josh Nasvik, sent an email to Mr. Monti itemizing the remaining repairs to be completed. At trial, Mr. Bartenwerfer testified that he understood that the items on the list were *230 all that needed to be resolved and that the list did not mention permits. When asked if he was aware at that time that the electrical permit had not been closed out, Mr. Bartenwerfer testified he was not sure what he thought at that time because "there was confusion" around the electrical sign off; i.e., one of the job cards showed the final electrical inspection was completed on January 30, 2008.

The Court does not find Mr. Bartenwerfer's testimony credible because, on February 19, 2008, Mr. Buckley sent an email to Henry Karnilowicz of Occidental Express, a company helping Mr. Bartenwerfer through the permitting process, stating "we failed yet another electrical inspection." Plaintiff's Ex. 16. Accordingly, the Court finds that and finds that on March 13, 2008, Mr. Bartenwerfer was aware that the electrical permit had not been closed out. Mr. Bartenwerfer testified that he did not think he informed Mr. Nasvik or Mr. Monti of the failed inspection prior to the close of escrow. Mr. Bartenwerfer also admitted that he did not request a modification of the Disclosures to reflect the failed inspection, though he considered it to be material.

Considering the totality of the circumstances, including those surrounding the other material non-disclosures, the Court finds that the Bartenwerfers omitted information about the status of permits up through the time of the close of escrow with the intent to deceive Plaintiff. The Disclosures would lead a reasonable person to believe that the only outstanding permit issues related to the kitchen, when in fact there were 10 outstanding permits that had continuing issues through to the time of close of escrow in March 2008 and beyond, including their expiration in January 2008. Though they received the Notice of Violation and failed inspections, the Bartenwerfers failed to notify Mr. Buckley of these issues despite their duty to do so until sometime after close of escrow. Accordingly, the Court finds and concludes that the Bartenwerfers had the requisite knowledge and intent to deceive Mr. Buckley with respect to non-disclosure of the status of permits.

4. Windows

The Bartenwerfers answered "No" to the question on the Disclosure Statement as to whether they were aware of "any

significant defects/malfunctions" in windows. Plaintiff's Ex. 2 at 3. They also did not disclose any problems with windows in the Supplemental Disclosure.

At the state court trial, Mike Barbie, a service technician for Pella Windows, testified that on February 7, 2008, he made a site visit to the Property and noted that several windows had been installed "out of square;" i.e., they were set crooked in the frames and did not function properly. Joint Designation of Trial Transcript Testimony—Mike Barbie at 14, 16–18. Mr. Barbie testified that he advised the Bartenwerfers of the problem and that it was an installation error. *Id.* at 22–23. He recalled telling the Bartenwerfers the following details:

In specific there was a window in front of the house that I believe there was some kind of a railing or something in the way. The window wouldn't open all the way, but it would not close all the way. And there is no adjustments we could to help even-you know, the frame was out of square. Typically what we would do is we can adjust the hinges to allow the window to close, but in this case the railings were in the way. And I said there was no way we could fix the window or adjust the window in the condition that it was because I was not able to open it up to adjust it. *231 Id. at 24–25. Mr. Barbie also told the Bartenwerfers that a window in the master bedroom had been installed out of square. Id. at 29. In addition, Mr. Barbie found that the windows were sticking between the weather stripping and the paint on the sash. Id. at 31. Mr. Barbie advised the Bartenwerfers to use paraffin wax to stop the sticking. Id. Mr. Barbie testified that the application of wax would not address the out of square issues. Id. at 32.

At trial in this proceeding, Mr. Bartenwerfer stated that he did not recall whether someone from Pella Windows had told him that the windows were out of square and needed to be reinstalled. He recalled being told that an installed door was out of square, and that his brother, Dale Bartenwerfer—who is not a contractor, has no expertise in California building codes, and has no education or training in building codes—told him all that of the window were working properly. Mr. Bartenwerfer testified during his state court trial proceeding that he did not disclose the problem with the door to Mr. Buckley because his contractor, Sergio Sepeda, told him that it was impossible for the doors to have been installed improperly and that therefore, Mr. Bartenwerfer believed the problem to be a manufacturing defect. Reporter's Transcript of Trial Proceedings David Bartenwerfer's Testimony, September 6, 2012 at 13. At trial in this proceeding, Mr. Bartenwerfer testified that he surmised that the problem with the windows was a manufacturing defect but does not know for sure. Mr. Bartenwerfer testified that he did not recall disclosing the suspected manufacturing defect to Mr. Buckley or to Mr. Monti.

The Court does not find Mr. Bartenwerfer's testimony that he was unaware that the windows had been installed out of square credible, because: (a) he had a conversation with his brother about whether the windows were working properly; (b) he testified at trial that he believed the window problem to be a manufacturing defect; and (c) Mr. Barbie's testimony as to what he told the Bartenwerfers about the windows being out of square is so detailed and specific and therefore, reliable and credible.

Regardless, even if they believed the window and door problems to be manufacturing defects rather than installation problems, the Bartenwerfers should have disclosed these defects to Mr. Buckley. Pella Windows was asked to come out to the Property as early as January 2, 2008, long before Mr. Buckley delivered his list of repairs to be made. This strongly suggests that the Bartenwerfers were aware of door and window problems before Mr. Buckley discovered them. Accordingly, based on the foregoing and the facts and circumstances surrounding the other non-disclosures, the Court finds and concludes that the Bartenwerfers had the requisite knowledge and intent to deceive Mr. Buckley with respect to non-disclosure of the window problems.

5. Fire Escape

The Disclosures contained no information about a fire escape. On October 26, 2008, Mr. Bartenwerfer received an email from Mr. Karnilowicz. Mr. Karnilowicz stated in the email,

I am somewhat concerned about you giving [the buyer] all the plans, which you will have to do, and I hope that he doesn't notice the missing fire escape. I think you ought to wait till the CFC is issued before you hand over the plans or permits.

Plaintiff's Ex. 17. On the same day, Mr. Bartenwerfer received an email from Mr. Buckley which stated,

For some reason the plans and permits you gave my real estate agent originally *232 do not match or even come close to what you had with the inspector present Friday, ie you had given us 2 stamped pages of drawings while you had in your possession it seemed like 70–80 pages, you had given us one permit and you had 15 permits taken out. I

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will need a copy of all those plans and the 15 permits as soon as possible.

Plaintiff's Ex. 22.

At trial, Mr. Bartenwerfer testified that Mr. Karnilowicz advised him that he should not provide the plans to Mr. Buckley because, if he did so, he would not be able to get a final sign off on all the building permits. Mr. Bartenwerfer testified that a previous iteration of the plans included a fire escape but the final version did not. He testified that he relied on the approved plans, that the plans did not include a fire escape, that no fire escape was required because it was a two-story house, and that he had not intended to install one.

Contrary to Mr. Bartenwerfer's testimony at trial suggesting that he had no duty to disclose the missing fire escape because it wasn't included in the final plans, the jury in the state court found the omission of the lack of a fire escape was material and caused harm to Mr. Buckley.

Accordingly, based on the email exchange between Mr. Bartenwerfer and Mr. Karnilowicz, the fact that Mr.

Bartenwerfer did not initially provide Mr. Buckley with a complete set of drawings and permits, and the facts and circumstances surrounding the other non-disclosures, the Court finds and concludes that the Bartenwerfers possessed the requisite knowledge and intent to deceive Mr. Buckley with respect to non-disclosure of the missing fire escape.

V. CONCLUSION

Based upon the above findings of fact and conclusions of law, the Court finds that Mr. Buckley has satisfied his burden of establishing by a preponderance of the evidence that the Bartenwerfers's debt to Mr. Buckley with respect to the non-disclosure of water leaks, window conditions, permits, and the fire escape is nondischargeable under section 523(a)(2) (A). Accordingly, the Court will enter judgment in favor of Mr. Buckley consistent with this memorandum decision.

All Citations

549 B.R. 222

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860 Fed.Appx. 544

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. 9th Cir. Rule 36-3.

United States Court of Appeals, Ninth Circuit.

IN RE: David William BARTENWERFER; Kate Marie Bartenwerfer, Debtors, Kieran Buckley, Appellant,

V.

David William Bartenwerfer; Kate Marie Bartenwerfer, Appellees. In re: David William Bartenwerfer; Kate Marie Bartenwerfer, Debtors, Kieran Buckley, Appellant,

v.

David William Bartenwerfer; Kate Marie Bartenwerfer, Appellees. In re: David William Bartenwerfer; Kate Marie Bartenwerfer, Debtors, David William Bartenwerfer; Kate Marie Bartenwerfer, Appellants,

v.

Kieran Buckley, Appellee.

No. 20-60021, No. 20-60023, No. 20-60024

Argued and Submitted July 29,
2021 San Francisco, California

|
FILED August 12, 2021

Synopsis

Background: Judgment creditor filed adversary complaint, seeking determination that debt was excepted from discharge because Chapter 7 debtors fraudulently concealed material defects plaguing renovated house that they sold to him prepetition. Following trial, the United States Bankruptcy Court for the Northern District of California, Hannah L. Blumenstiel, J., 549 B.R. 222, ruled that debt was nondischargeable, and appeals were taken. The Bankruptcy

Appellate Panel, 2017 WL 6553392, affirmed judgment as to debtor-husband, but vacated and remanded as to debtor-wife. On remand, the Bankruptcy Court, Blumenstiel, J., 596 B.R. 675, entered judgment in favor of debtor-wife. Judgment creditor appealed. The Bankruptcy Appellate Panel, 2020 WL 1970506, affirmed. Cross-appeals were taken.

Holdings: The Court of Appeals held that:

[1] collateral estoppel did not bar judgment creditor's nondischargeability claim, and

[2] in ruling that debtor-husband's fraud was not imputed to debtor-wife, the Bankruptcy Court applied the incorrect legal standard for imputed liability in a partnership relationship.

Affirmed in part, reversed in part, and remanded with instructions.

West Headnotes (2)

[1] Judgment 📻 Bankruptcy

Collateral estoppel did not bar judgment creditor's nondischargeability claim against Chapter 7 debtors; in judgment creditor's prepetition state-court action against debtors, jury's findings in favor of judgment creditor on his claim for debtors' alleged nondisclosure of material facts, but not on his claim for intentional misrepresentation, were conflicting, or at least ambiguous. 11 U.S.C.A. § 523(a)(2)(A).

[2] Bankruptcy ← Fraud committed by agent or one other than debtor

In judgment creditor's adversary proceeding against Chapter 7 debtors under the fraud discharge exception, in connection with debtors' alleged fraudulent concealment of material defects in renovated house that they sold to him prepetition, the Bankruptcy Court applied the incorrect "knew or should have known" legal standard for imputed liability in a partnership relationship to conclude that debtor-husband's

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fraud was not imputed to his partner, debtorwife; under the correct standard, debtor-wife's debt was nondischargeable regardless of her knowledge of the fraud. 11 U.S.C.A. § 523(a)(2) (A).

2 Cases that cite this headnote

*545 Appeal from the Ninth Circuit Bankruptcy Appellate Panel, Brand, Jury, and Faris, Bankruptcy Judges, Presiding, Taylor, Faris, and Brand, Bankruptcy Judges, Presiding, BAP No. 16-1277, BAP No. 19-1016

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Before: McKEOWN and NGUYEN, Circuit Judges, and HUCK,* District Judge.

* The Honorable Paul C. Huck, United States District Judge for the U.S. District Court for Southern Florida, sitting by designation.

MEMORANDUM**

This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36-3.

As partners, David and Kate Bartenwerfer renovated a house in San Francisco, California and sold it to Kieran Buckley. Shortly after the sale, Buckley alleged defects in the house and sued the Bartenwerfers in California state court for (1) breach of contract, (2) negligence, (3) nondisclosure of material facts, (4) negligent misrepresentation, and (5) intentional misrepresentation. The jury found in Buckley's favor on his breach of contract, negligence, and nondisclosure of material facts claims and against him on his remaining claims and awarded him damages. The Bartenwerfers filed for bankruptcy.

In the bankruptcy court, Buckley initiated an adversary proceeding against the Bartenwerfers, arguing that the state court judgment against the Bartenwerfers could not be discharged in bankruptcy under 11 U.S.C. § 523(a)(2) (A), which provides *546 that a debtor cannot discharge debt that was obtained through fraud. The bankruptcy court agreed and held that the portion of the state court judgment that was traceable to Buckley's nondisclosure claim was nondischargable. The bankruptcy court found that the Bartenwerfers intended to deceive Buckley and held that Mr. Bartenwerfer had actual knowledge of the false representations made to Buckley and that Mr. Bartenwerfer's fraudulent conduct could be imputed onto Mrs. Bartenwerfer because of their partnership relationship. Additionally, the bankruptcy court declined to apply collateral estoppel in favor of the Bartenwerfers based on the jury's findings of no intentional fraud. On appeal, the Ninth Circuit Bankruptcy Appellate Panel ("BAP") affirmed the bankruptcy court's collateral estoppel ruling, but, adopting the Eight Circuit's "knew or should have known" standard from Walker v. Citizens State Bank, 726 F.2d 452 (8th Cir. 1984), remanded the imputed liability finding and instructed the bankruptcy court to determine whether Mrs. Bartenwerfer "knew or should have known" of Mr. Bartenwerfer's fraud. On remand, after an evidentiary hearing, the bankruptcy court held that Mr. Bartenwerfer's fraud could not be imputed onto Mrs. Bartenwerfer because she did not know of the fraud. The BAP affirmed.

Buckley appeals the BAP's decision affirming the bankruptcy court's nondischargeability judgment in favor of Mrs. Bartenwerfer. On cross-appeal, the Bartenwerfers argue that collateral estoppel should apply to bar Buckley's § 523(a)(2) (A) claim. We have jurisdiction under 28 U.S.C. § 158(d), and we affirm in part and reverse in part.

[1] We begin with the Bartenwerfers' cross-appeal. The Bartenwerfers argue that collateral estoppel applies because the state court jury found in their favor on Buckley's intentional misrepresentation claim. The jury found in favor of Buckley on his nondisclosure of material facts claim against the Bartenwerfers, but not on his intentional misrepresentation claim. These two findings are conflicting, or at least ambiguous, which weigh against applying collateral estoppel. *See In re Kelly*, 182 B.R. 255, 258 (9th Cir. BAP 1995) ("Any reasonable doubt as to what was decided by a prior judgment should be resolved against allowing the

In re Bartenwerfer, 860 Fed.Appx. 544 (2021)

collateral estoppel effect."), *aff'd*, 100 F.3d 110 (9th Cir. 1996). We affirm on this issue.

[2] In his appeal, Buckley argues that the bankruptcy court erred by failing to apply binding Supreme Court and Ninth Circuit precedent to the question of whether to impute Mr. Bartenwerfer's fraud onto his partner, Mrs. Bartenwerfer, and by holding that the fraud was not imputed. Buckley is correct. Applying basic partnership principles,

if, in the conduct of partnership business, ... one partner makes false or fraudulent misrepresentations of fact to the injury of innocent persons, ... his partners cannot escape pecuniary responsibility therefor upon the ground that such misrepresentations were made without their knowledge. This is especially so when ... the partners, who were not themselves guilty of wrong, received and appropriated the fruits of the fraudulent conduct of their associate in business.

Strang v. Bradner, 114 U.S. 555, 561, 5 S.Ct. 1038, 29 L.Ed. 248 (1885); see also In re Cecchini, 780 F.2d 1440, 1444 (9th Cir. 1986) (holding a partner responsible for a tortfeasor/partner's fraud when the fraud was performed "on behalf of

the partnership and in the ordinary course of the business of the partnership"), overruled in other part by Kawaauhau v. Geiger, 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998). Mrs. Bartenwerfer's debt is nondischargeable *547 regardless of her knowledge of the fraud. By rejecting Strang and Cecchini, in favor of the "knew or should have known" standard, the bankruptcy court applied the incorrect legal standard for imputed liability in a partnership relationship. We reverse the bankruptcy court's judgment regarding imputed liability against Mrs. Bartenwerfer under § 523(a)(2)(A), and we remand to the bankruptcy court with instructions to enter judgment in favor of Buckley and against Mrs. Bartenwerfer.

We need not address the remaining issues raised on Buckley's direct appeal.

AFFIRMED IN PART; REVERSED IN PART AND REMANDED.

All Citations

860 Fed.Appx. 544

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DECEMBER 8, 2022

Bartenwerfer Argument Invites the Supreme Court to Depart from 'Plain Meaning'

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Will the Supreme Court add words to Section 523(a)(2) (A) to yield a result that the justices find more palatable?

Hearing argument on December 6, the Supreme Court will decide in *Bartenwerfer v. Buckley* whether a debtor is saddled with a nondischargeable debt for a false representation or actual fraud under Section 523(a)(2)(A) based entirely on the fraud of a partner or an agent.

In other words, does vicarious liability for fraud also result automatically in nondischargeability, or will the Court impute extra words to the statute and hold that the debtor must have some degree of scienter before the debt is excepted from discharge?

https://www.abi.org/newsroom/daily-wire/bartenwerfer-argument-invites-the-supreme-court-to-depart-from-'plain-meaning'

Bartenwerfer Argument Invites the Supreme Court to Depart from 'Plain Meaning' | ABI

The 'Innocent' Wife

A couple owned a home. They moved out to renovate and then sell the home. The husband oversaw the renovations. The wife had little to do with the renovations. After renovation, they sold the home.

The buyers sued in state court, alleging fraud in the disclosure statement for failure to disclose known defects in the home. A jury found the couple liable, resulting in a judgment against them for about \$540,000, plus interest. The wife was liable for the husband's fraud because the relationship between the husband and wife was found to be a partnership under state law.

The couple filed a chapter 7 petition, and the bankruptcy court ruled that the debt was nondischargeable as to the husband.

The bankruptcy court discharged the debt as to the wife, finding that she neither knew nor should have known that the disclosures were fraudulent. *See Buckley v. Bartenwerfer (In re Bartenwerfer)*, 596 B.R. 675 (Bankr. N.D. Cal. 2019). The Ninth Circuit Bankruptcy Appellate Panel affirmed in a nonprecedential opinion. *See Bartenwerfer v. Buckley (In re Bartenwerfer)*, 16-1277, 2017 BL 461730, 2017 Bankr. Lexis 4396, 2017 WL 6553392 (B.A.P. 9th Cir. Dec. 22, 2017).

The Ninth Circuit reversed in a nonprecedential opinion and directed the bankruptcy judge to enter judgment in favor of the creditor, declaring the debt to be nondischargeable. *Buckley v. Bartenwerfer (In re Bartenwerfer)*, 860 Fed. Appx. 544 (9th Cir. Aug. 12, 2021).

On the same question, the circuits are split. The Second, Fourth, Seventh and Eighth Circuits hold that the debtor must have some degree of scienter before an imputed liability for fraud becomes nondischargeable.

To the contrary, the Fifth, Sixth, Ninth and Eleventh Circuits hold that a debt is nondischargeable as to an entirely innocent debtor based on the fraud of a partner or agent.

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Raising the circuit split, the debtor-wife filed a petition for *certiorari* one year ago. The Supreme Court granted the petition on May 2 and held argument on December 6. To read one of ABI's stories on *Bartenwerfer*, **click here**.

The debtor's petition stated the question presented as follows:

May an individual be subject to liability for the fraud of another that is barred from discharge in bankruptcy under 11 U.S.C. § 523(a)(2)(A), by imputation, without any act, omission, intent or knowledge of her own?

Oral Argument Focuses on Limits

Arguably, the debtor is asking the Supreme Court to add words to the statute. Section 523(a)(2)(A) says that a discharge under Section 727 "does not discharge an individual debtor from any debt . . . for money . . . to the extent obtained by . . . a false representation, or actual fraud"

At oral argument, the justices uniformly seemed to say that the statute favors nondischargeability. Unlike Sections 523(a)(2)(B) or (a)(6), for instance, Section 523(a)(2)(A) has no reference to the conduct of the debtor.

The outcome, however, is not open and shut. The content of Section 523(a) is the product of more than 100 years of piecemeal legislation by Congress. One justice said that the statute seems "haphazard," and another asked whether the different formulations were the result of "carelessness" by Congress.

Many of the justices' questions probed the extent to which Section 523(a)(2) (A) must be read literally. Justices Clarence Thomas and Sonia Sotomayor offered hypotheticals to test "plain meaning."

Justice Thomas imagined a case where an infant child was a partner. Would a debt for fraud be nondischargeable as to an infant? Justice Sotomayor offered a case where a loan was obtained fraudulently, but the borrower transferred the debt to someone not aware of the fraud. Would the debt be nondischargeable as to the transferee, she asked?

The debtor argued that state law establishes rules for vicarious liability but does not define dischargeability. In contrast, the Bankruptcy Code points in a

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different direction by narrowing the grounds on which a debt is nondischargeable, the debtor said. In the decision that might come down in the first quarter of 2023, the Court may explore the extent to which state law formulations of vicarious liability control the outcome under Section 523.

Sarah M. Harris, from the Washington, D.C., office of Williams & Connolly LLP, argued for the debtor.

Zachary D. Tripp, from the Washington, D.C., office of Weil Gotshal & Manges LLP, argued for the creditor. Assistant Solicitor General Erica L. Ross argued as *amicus* for the government on behalf of the creditor.

Prediction

At least two justices were worried about reading the statute literally, offering exaggerated situations where nondischargeability would offend notions of fairness. On the other hand, it would be difficult for the Court to insert words into a statute that has been amended repeatedly by Congress.

In an era where the Supreme Court hews to statutory language, this writer presumes that the justices will affirm and find the debt to be nondischargeable, because the wife was a partner under state law. This writer suspects that the Court's opinion will attempt to limit the holding to the facts of the case without insinuating that plain language must control in every conceivable circumstance.

On the other hand, reversing and discharging the debt would be a watershed moment in interpreting the Bankruptcy Code. Reversal would reinvigorate the equity powers of the bankruptcy court after years of erosion by the Supreme Court.

Opinion Link

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Case Details

Case Citation Bartenwerfer v. Buckley,

21-908 (Sup. Ct.)

Case Name Bartenwerfer v. Buckley

Case Type <u>Business</u>

Court <u>Supreme Court</u>

Bankruptcy Tags Fraud Fraudulent Transfers

Practice and Procedure Consumer Bankruptcy

<u>Discharge/Dischargeability</u> <u>Business Reorganization</u>

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United States Bankruptcy Court,
N.D. Georgia, Atlanta Division.

IN RE: John Fitzgerald CARTER, Debtor.

Case No. 23-54816-JWC | Signed December 13, 2023

Attorneys and Law Firms

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Lindsay P. S. Kolba, Office of the U.S. Trustee, Atlanta, GA, for U.S. Trustee.

MEMORANDUM OPINION AND ORDER

Jeffery W. Cavender, United States Bankruptcy Judge

*1 The question before the Court is whether a corporation in a pending chapter 7 bankruptcy case was still an "affiliate" of its owner when the owner filed his own chapter 11 bankruptcy case. The issue is important for debtors like John Carter, who seeks relief under subchapter V of chapter 11 of the Bankruptcy Code ("Subchapter V"). When Carter filed this case, he was the majority-owner of two companies that have been in chapter 7 bankruptcy cases for years. If he was still an affiliate of these two companies when he filed his case, and if the combined debts of Carter and the companies exceed \$7,500,000, Carter is not eligible to be a debtor under Subchapter V. This issue could affect other business owners who seek the protection of Subchapter V days, weeks, months, or years after their companies become debtors in chapter 7 bankruptcy cases. Should Subchapter V be closed to individuals, potentially for years, while a chapter 7 trustee administers the estate of a previous failed business? The Court is mindful of the potential consequences of excluding such principals from the class of debtors who otherwise would be entitled to proceed under Subchapter V, but the plain language and structure of the Bankruptcy Code compel the Court to conclude that Carter and his businesses were still "affiliates" for purposes of eligibility to proceed under Subchapter V when he commenced this case. To hold otherwise would require the Court to ignore not only the plain language of Subchapter V's eligibility provision, but also numerous other provisions of the Bankruptcy Code and related statutes implicated by Carter's affiliate arguments. The Court further concludes that Carter failed to carry his burden of establishing that the combined debts of Carter and his affiliates in chapter 7 do not exceed \$7,500,000, rendering him ineligible for relief under Subchapter V.

All references or citations to a statute are to the "Bankruptcy Code," 11 U.S.C. § 101 et seq., unless otherwise specified. All references or citations to a Bankruptcy Rule are to the Federal Rules of Bankruptcy Procedure.

I. FINDINGS OF FACT

A. Carter's Bankruptcy Case

Carter filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code, electing to proceed under Subchapter V on his petition. The U.S. Trustee timely filed an objection to the election, Carter filed a response, and the Court held a hearing on the objection. The parties submitted supplemental briefing and a stipulation of facts following the hearing.

On his petition in response to the question, "[a]re any bankruptcy cases pending or being filed by... a business partner, or by an affiliate," Carter disclosed the bankruptcy cases of D&N Electric, A Carter Brothers Company ("D&N"), Case No. 16-72113, and Carter Brothers Security Services, LLC ("CBSS"), Case No. 18-61490. Carter identified his relationship with D&N and CBSS as "Affiliate." [Doc. No. 1]. Carter subsequently amended his voluntary petition to identify his relationship with both entities as "Non-statutory Affiliate." [Doc. No. 23].

*2 In his Statement of Financial Affairs [Doc. No. 18], and again in his amended Statement of Financial Affairs [Doc. No. 24], Carter disclosed transfers to the chapter 7 estates of D&N and CBSS within two years prior to his petition date. Carter identified his relationship with D&N and CBSS as "Affiliates in Chapter 7."

D&N filed a voluntary petition under chapter 11 of the Bankruptcy Code in December of 2016. The Court appointed a chapter 11 trustee over D&N's estate in June of 2018 after it was discovered that D&N, under the control of Carter, attempted to sell estate assets without Court authority. The Court converted the D&N case to a chapter 7 case in August of 2018, and the chapter 11 trustee was appointed as the chapter

7 trustee. Carter owns 65% of the stock of D&N. The D&N case remains pending.

CBSS filed a voluntary petition under chapter 7 of the Bankruptcy Code in July of 2018. Carter owns 99% of the membership interests in CBSS and signed the petition as "Managing Member." The CBSS petition discloses D&N as an affiliate with a pending bankruptcy case and a relationship described as "affiliate – common ownership." The CBSS case remains pending.

II. CONCLUSIONS OF LAW²

The Court has jurisdiction over this proceeding pursuant to 28 U.S.C. § 1334. This proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A).

Carter elected to proceed under Subchapter V on his petition as required by Bankruptcy Rule 1020(a), and the U.S. Trustee timely objected to his election pursuant to Bankruptcy Rule 1020(b). Bankruptcy Code § 1182 defines who may be a debtor under Subchapter V and excludes from eligibility "any member of a group of affiliated debtors under this title that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than \$7,500,000 (excluding debt owed to 1 or more affiliates or insiders)." 11 U.S.C. § 1182(1)(B)(i). The U.S. Trustee contends Carter is not eligible because he, D&N, and CBSS are a group of affiliated debtors with aggregate non-insider, noncontingent liquidated debts exceeding \$7,500,000. Carter maintains that he is eligible, arguing that neither D&N nor CBSS were still his affiliates when he filed his case because those entities were controlled by chapter 7 trustees on his petition date. Carter also contends that even if they are affiliates, their aggregate debt does not exceed \$7,500,000.

A. The Debtor Has the Burden of Proof to Establish Eligibility

The Bankruptcy Code and Bankruptcy Rules do not address who carries the burden of proof on a debtor's Subchapter V eligibility when an objection is filed. *NetJets Aviation, Inc. v. RS Air, LLC (In re RS Air, LLC)*, 638 B.R. 403, 413 (B.A.P. 9th Cir. 2022). The U.S. Trustee argues the burden is on the debtor, citing numerous cases in support, and she is correct that a significant majority of courts conclude that debtors bear the burden of proof for Subchapter V eligibility by a preponderance of the evidence. The rationale is that Subchapter V gives significant advantages to debtors compared to traditional chapter 11 reorganizations. *In re RS*

Air, LLC, 638 B.R. at 414; *In re Evergreen Site Holdings, Inc.*, 652 B.R. 307, 316 (Bankr. S.D. Ohio 2023). Further, it "makes sense to place the burden on the debtor because debtors are in the best position to prove that they are qualified to be in subchapter V." *In re RS Air, LLC*, 638 B.R. at 414.

- E.g., In re RS Air, LLC, 638 B.R. at 414; In re Rickerson, 636 B.R. 416, 422 (Bankr. W.D. Pa. 2021); In re Family Friendly Contracting LLC, No. 21-14213, 2021 WL 5540887, at *2 (Bankr. D. Md. Oct. 26, 2021); In re Vertical Mac Constr., No. 6:21-01520, 2021 WL 3668037, at *2 (Bankr. M.D. Fla. July 23, 2021); In re Port Arthur Steam Energy, L.P., 629 B.R. 233, 235 (Bankr. S.D. Tex. 2021); In re Blue, 630 B.R. 179, 187 (Bankr. M.D.N.C. 2021); In re Offer Space, LLC, 629 B.R. 299, 304 (Bankr. D. Utah 2021); In re Ikalowych, 629 B.R. 261, 275 (Bankr. D. Col. 2021); In re Sullivan, 626 B.R. 326, 330 (Bankr. D. Colo. 2021); In re Johnson, No. 19-42063, 2021 WL 825156, at *4 (Bankr. N.D. Tex. Mar. 1, 2021); In re Thurmon, 625 B.R. 417, 419 n.4 (Bank. W.D. Mo. 2020); In re Blanchard, No. 19-1244, 2020 WL 4032411, at *2 (Bankr. E.D. La. July 16, 2020); In re Wright, No. 20-01035, 2020 WL 2193240, at *2 (Bankr. D.S.C. Apr. 27, 2020).
- *3 Carter cited no authority in his briefing in opposition to the majority position, but at the hearing his counsel noted a split in authority on the issue and cited *In re Serendipity* Labs, Inc., 620 B.R. 679, 680 n.3 (Bankr. N.D. Ga. 2020) for the proposition that the burden of proof is on the objecting party to establish ineligibility. In Serendipity Labs, Judge Sigler generally cited favorably to In re Body Transit, Inc., 613 B.R. 400, 409 n.15 (Bankr. E.D. Pa. 2020), one of the few cases finding the objecting party has the burden. Judge Sigler noted, however, that case law at the time of Serendipity Labs was limited, and many of the cases cited for the majority position issued after Serendipity Labs. Further, it is questionable whether Judge Sigler ruled that the objecting party bears the burden because the objecting party in that case did not challenge the burden issue, and Judge Sigler stated only that "[t]he limited caselaw on this issue is generally consistent in placing the burden on the moving party. Even if the moving party has the burden of proof, [it] has carried that burden." Serendipity Labs, Inc., 620 B.R. at 680 n.3 (citations omitted). Regardless, the clear trend since Serendipity Labs is to place the burden on the debtor, and the Court agrees with the majority position. The Court concludes Carter bears the burden of proof on eligibility under Subchapter V.

B. D&N and CBSS Are Affiliates of John Carter

The first question before the Court is whether Carter, D&N, and CBSS were "affiliated debtors under this title" on the petition date of this case. No one questions that Carter, D&N, and CBSS were "debtors under this title." The parties dispute only whether they were "affiliated" on the petition date. Carter argues they were not affiliated because D&N and CBSS were controlled by chapter 7 trustees when he filed his petition. This precise issue appears to be one of first impression. Few cases have analyzed debtor eligibility under § 1182(1)(B), and the decisions that have answered different questions. ⁵

- See In re Dobson, Case No. 23-60148, 2023 WL 3520546 (Bankr. W.D. Va. May 17, 2023) (holding that eligibility is determined as of petition date and subsequently-filed cases of affiliates do not impact eligibility); In re Free Speech Systems, LLC, 649 B.R. 729 (Bankr. S.D. Tex. 2023) (similar).
- See, e.g., In re Dobson, supra n.4; In re Free Speech Systems, LLC, supra n.4; In re Parking Mgmt, Inc., 620 B.R. 544 (Bankr. D. Md. 2020) (deciding whether lease rejection claims count toward debt limit); Serendipity Labs, 620 B.R. 679 (deciding whether non-debtor owner of debtor was an affiliate).

The term "affiliate" is defined in § 101(2), which provides, in relevant part:

The term "affiliate" means—...

corporation 20 percent or more of whose outstanding *voting securities* are directly or indirectly owned, controlled, or held with power to vote, by the debtor

11. U.S.C. § 101(2)(B) (emphasis added). The parties stipulate that Carter owns 65% of the stock of D&N and 99% of the LLC membership interests of CBSS, but they disagree as to whether such stock and membership interests are "voting securities."

The phrase "voting securities" is not defined by the Bankruptcy Code, but "security" is defined in § 101(49). Stock clearly falls within the definition of "security" under § 101(49)(ii), and LLC membership interests may also be considered a "security." Carter does not dispute that he owns securities.

See In re Phenomenon Mktg. & Entm't, LLC, 2:22-BK-10132-ER, 2022 WL 1262001, at *3 (Bankr. C.D. Cal. Apr. 28, 2022), modified, 2:22-BK-10132-ER, 2022 WL 3042141 (Bankr. C.D. Cal. Aug. 1, 2022) (citing

D.R. Mason Const. Co. v. GBOD, LLC, 17-ev-01779, 2018 WL 1306425, at *5 (S.D. Cal. Mar. 13, 2018)).

Nor does he challenge that the securities he owns were "voting securities" prior to the D&N and CBSS cases. Instead, he argues that the appointment of chapter 7 trustees over D&N and CBSS effectively nullified whatever voting rights he had, and that his ownership rights in the two entities, whatever they were before the D&N and CBSS cases, no longer meet the definition of "voting securities" as of the commencement of this case. Carter cites no authority directly in support of his position, and the argument appears to be quite novel. Its novelty, however, does not make it unworthy of serious consideration.

*4 Carter first cites cases finding that the definition of "affiliate" is meant to be precise and restrictive. See Palmdale Hills Prop. v. Argent Mgmt., LLC (In re Palmdale Hills Prop.), 2017 Bankr. LEXIS 3534, *28-29 (quoting Wilson v. Huffman (Matter of Missionary Baptist Found.), 712 F.2d 206, 210 (5th Cir. 1983)). He then relies considerably on the definition of "voting securities" adopted by the Securities and Exchange Commission in the Code of Federal Regulations: "The term voting securities means securities the holders of which are presently entitled to vote for the election of directors." 17 C.F.R. § 230.405. Carter argues he is not presently entitled to vote for the election of directors because the chapter 7 trustees alone control D&N and CBSS and, if he has a technical right to vote for directors, "such a power is illusory." Carter's Supp. Brief, Doc. No. 38, p. 6. He cites Commodity Futures Trading Com v. Weintraub, 471 U.S. 343, 352-53 (1985), for the proposition that "when a trustee is appointed, he assumes control of the business, and the debtor's directors are 'completely ousted.' "He further cites the legislative history of § 101(2) for the proposition that "'affiliate' is 'intended to cover situations where there is an opportunity to control' a debtor." Carter's Supp. Brief, p. 6 (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 309 (1977)). Finally, he cites In re Piece Goods Shops Co., 188 B.R. 778, 797 (Bankr. M.D.N.C. 1995) for the proposition that "[c]ourts have effectuated this expressed legislative intent in holding, consistent with the SEC definition of 'voting securities,' that the extent of a security holder's voting power is the appropriate measure of determining whether one is an 'affiliate' of a debtor for 'insider' purposes." Id. In short, Carter argues that when a chapter 7 trustee takes over a corporate debtor's estate, the owners lose all meaningful voting power and control, effectively transforming an owner's "voting securities" into something other than "voting securities."

Carter's position avoids a seemingly harsh result to certain individuals seeking eligibility under Subchapter V, which was enacted to facilitate chapter 11 reorganizations for small businesses. In re Parking Mgmt, Inc., 620 B.R. at 549. Further, his position avoids the unsatisfying result of excluding him from Subchapter V based on years-old chapter 7 cases while debtors like those in Free Speech and Dobson were allowed to proceed under Subchapter V even though they involved what some have argued is gaming the eligibility requirements by filing cases of eligible debtors as little as one day before filing affiliate cases that would otherwise render the firstfiled debtor ineligible. Whether or not the affiliated group of debtors that can exclude otherwise eligible debtors from Subchapter V should include long-defunct businesses in protracted chapter 7 bankruptcies over which the owners lost effective control years ago, Carter's proposed solution simply does not work.

The Court has not previously ruled on the issue raised in *Free Speech* or *Dobson* and does not do so here. The Court points to those cases merely as an example of what some might consider an unsatisfying juxtaposition of the results in those cases and the result in this case.

First, Carter's argument is contrary to common bankruptcy usage and practice. Carter himself identified both D&N and CBSS as affiliates in his original petition and Statement of Financial Affairs. It was only after the 341 meeting in his case that he amended his petition to describe the relationship as "non-statutory affiliates," whatever that term means. 8 The CBSS petition also identified D&N as an affiliate despite the appointment of a chapter 11 trustee over D&N at the time CBSS filed its chapter 7 case. Neither Carter nor the Court's own research uncovered any cases even suggesting that an owner of 20% or more of a debtor's voting securities ceases to be an affiliate of a debtor in chapter 7 upon appointment of a trustee. The Court has, however, found one unpublished decision rejecting out of hand a similar argument in the context of a chapter 11 trustee. See In re TS Employment, Inc., Case No. 15-10243, 2015 WL 9490348, *2 n.4 (Bankr. S.D.N.Y. Aug. 18, 2015).

As Carter points out, the definition of "affiliate" is intended to be precise, restricted, and not subject to expansion beyond the statutory definition.

Second, the plain language of § 1182(1)(B)(i) includes debtors under all of title 11, not just debtors in non-chapter 7 cases or non-trustee cases. *See In re Dobson*, 2023 WL 3520546 at *4 ("Congress in amending the statute made it

abundantly clear that the term 'debtors' in section 1182(1)(B) (i) is not limited to a group of affiliated debtors which are all proceeding under subchapter V-it was made clear that the debt of any affiliate debtor under any chapter be counted in the calculation."). Carter's position is that no chapter 7 debtor, or any debtor with a trustee appointed, 9 should ever be considered when determining Subchapter V eligibility. If Congress had intended such a broad exclusion of all chapter 7 debtors, it would be odd to do it by using the broad umbrella of "title 11" on the face of § 1182, only to bury the real intention to exclude chapter 7 debtors, wholesale, through a novel interpretation of the term "affiliate." It is even more implausible to do it through the definition of "voting securities" promulgated by the SEC in the CFR, which, according to the Court's research, had been cited only once in any bankruptcy case in the context of the definition of "affiliate" prior to the enactment of Subchapter V. See Piece Goods Shops, 188 B.R. at 797. Piece Goods Shops, however, had nothing to do with chapter 7 debtors or whether holders of prepetition voting securities remain affiliates following the appointment of a trustee. It involved whether the holders of class B and preferred stock that did not have the contractual power to vote for the debtor's directors were insiders of a chapter 11 debtor for purposes of voting on a plan. Id.

The Court sees no functional difference between a chapter 7 trustee and chapter 11 trustee as it pertains to Carter's arguments. Indeed, the "completely ousted" language from *Commodity Futures* originates from language in the legislative history discussing chapter 11 trustees. *Commodity Futures*, 471 U.S. at 353 n.6.

*5 The only other case cited by Carter or found by the Court that adopts the CFR definition of "voting securities" for purposes of § 101(2) is *Serendipity Labs*, 620 B.R. at 683, which came after the enactment of Subchapter V and in no way suggests that "voting securities" should be interpreted to mean chapter 7 debtors and their owners cease to be affiliates upon appointment of a trustee. If anything, the opposite is true, as Judge Sigler found actual ability to vote a voting security is not dispositive to the question of affiliation: "that the entity that owns a debtor's stock happens to lose or surrender the power to vote the stock (while retaining ownership) should not change that entity's status as an affiliate." 620 B.R. at 685 (citing *In re Interlink Home Health Care, Inc.*, 283 B.R. at 438-39).

In short, nothing cited by Carter suggests that Congress intended to contradict the plain language of § 1182 by

harnessing the definition of "affiliate" and "voting securities" and applying them in such a novel way.

Third, assuming the CFR definition of "voting securities" is appropriate, the Court is not convinced that Carter is not "presently entitled to vote for the election of directors." His ability to vote for the election of directors certainly has limited value following the appointment of a chapter 7 trustee, but Carter offers no authority suggesting Carter is not able to elect directors of a debtor in chapter 7, limited power though they may have.

Nor is the Court convinced that appointment of a chapter 7 trustee renders an owner's voting power nugatory. Notwithstanding dicta in Commodity Futures that a chapter 7 debtor's directors are "completely ousted." chapter 7 debtors have various obligations and retain various rights in a chapter 7 case, and someone must perform those obligations and exercise those rights on behalf of a corporate debtor. 11 Although neither the parties nor the Court have found any authority addressing the issue, presumably it would be up to the owners with voting power to control who performs those obligations and exercises those rights. The point is not to suggest that these rights have any significant value in the D&N or CBSS cases, or in most chapter 7 cases, but nothing in the definition of "affiliate" or "voting securities" requires that voting rights have value, and the rights can continue to exist even after a chapter 7 case is fully administered and closed. 12 Therefore, they can exist in any given chapter 7 case, and it is not correct to say that directors of a chapter 7 debtor, per se, have no authority of any kind or that the ability to elect those directors serves no purpose whatsoever.

- Commodity Futures analyzed the specific question of whether a chapter 7 trustee control's a corporate debtor's power to waive attorney-client privilege. It had nothing to do with the meaning of affiliate or voting securities and did not address in any way the issue presently before this Court.
- A chapter 7 debtor must file schedules, cooperate with the trustee, and produce records, 11 U.S.C. § 521; must appear and testify at the meeting of creditors, 11 U.S.C. § 343; and is subject to examination under Bankruptcy Rule 2004(d). Compliance with these obligations can have important ramifications for owners, and it is often in their best interest to maintain control of who performs these obligations on behalf of a corporate chapter 7 debtor. As for rights, a chapter 7 debtor may convert a chapter 7 case to a chapter 11 case, 11 U.S.C. § 706(a);

file proofs of claims on behalf of creditors, Bankruptcy Rule 3004, which may benefit an owner by paying obligations for which the owner is also liable; control property that does not become property of the estate, see, e.g., 11 U.S.C. § 541(b)(1); take control of assets abandoned by a trustee that revert to the debtor, see, e.g., In re Renaissance Stoneworks, L.L.C., 317 B.R. 817, 820 (Bankr. E.D. Mich. 2007) ("There is no authority in the Bankruptcy Code for the abandonment of property of the estate to ... any party other than the debtor."); and may be able to file motions to require a trustee to abandon property, Bankruptcy Rule 6007(b). Further, as Carter points out, in surplus cases chapter 7 debtors may file objections to claims and assert other rights. In re Kehoe, 221 B.R. 285, 288 ("[T]he law is wellsettled that Chapter 7 debtors do have standing to appeal orders that directly affect their interests and, in limited circumstances, orders affecting the estate.").

The parties stipulate to the fact that both D&N and CBSS were dissolved according to the records of the Georgia and Florida Secretaries of State as of Carter's petition date, but neither party suggests what relevance this fact has to their positions. The Court's own research reveals that dissolution alone under relevant state law does not end the existence of a corporate entity. See O.C.G.A. § 14-2-1405. O.C.G.A. § 14-2-1421(c); Fla. Stat. § 605.0714(5). Further, D&N, a Georgia Corporation, was merely administratively dissolved, and administratively dissolved corporations may be reinstated within five years. O.C.G.A. § 14-2-1422(a). It could be that dissolution of a corporate entity, at some point, terminates an owner's voting securities under relevant state law, but the Court does not believe that administrative dissolution (a common occurrence for small businesses whether operating or not) should be the inflection point. Without the benefit of briefing or argument on the issue, the Court declines to make any decision on the effect of the dissolution of D&N and CBSS in this case.

*6 Fourth, harnessing the definition of "affiliate" as the means to avoid a potentially harsh result in the context of § 1182 could open Pandora's box by affecting other sections of the Bankruptcy Code in which the term "affiliate" is implicated. The term "affiliate" by itself appears in at least 6 sections of the Bankruptcy Code other than §§ 101 and 1182. See §§ 362(b)(19), 363(b)(1), 510(b), 524(g)(4), 1125(e), 1129(5), 1145(a). It appears in 5 other defined terms under § 101. See §§ 101(12A) (debt relief agency); (22A) (financial participant); (31) (insider); (41) (person); (51D) (Small Business Debtor). It appears in three Bankruptcy Rules. See Fed. R. Bankr. P. 1014, 1015, 2019. It also

appears in 28 U.S.C. § 1408, which provides for venue for title 11 cases in, among other places, "the district court for the district ... (2) in which there is pending a case under title 11 concerning such person's affiliate, general partner, or partnership."

Although the Court appreciates Carter's effort to assuage concerns about how his proposed interpretation would affect other Bankruptcy Code provisions, he analyzes only five Bankruptcy Code provisions containing the term "affiliate" itself. He ignores the venue statute, all Bankruptcy Rules, and all instances of the five defined terms that include the term "affiliate." It is hard to blame him for not engaging in a more fulsome analysis because it would be nearly impossible to do so without going so deep down a rabbit hole that one risks falling into Wonderland. Suffice to say that the Court's concerns are not assuaged. Of particular concern are the potential effect on the venue statute and related rules and the definition of "insider," which Carter fails to address at all. These are significant omissions.

The Court reaches this conclusion based on its own efforts to reconcile Carter's proposed interpretation with the numerous statutes and rules implicated.

"Affiliate is defined primarily for use in the definition of insider... and for use in the chapter 11 reorganization cases." H.R. Rep. No. 595, 95th Cong., 1st Sess. 309 (1977). Carter focuses on the second half of that sentence while ignoring the first. The number of Bankruptcy Code provisions containing the term "insider" is at least 16, and several could be directly impacted by a ruling that an owner of a business ceases to be an affiliate of a company once it files a chapter 7 case. See, e.g. 11 U.S.C. § 503(c) (heightened scrutiny for certain administrative claims of insiders), § 524(a)(2)(A) and (B) (statements concerning financial condition of insiders), § 547(b)(4)(B) (extended look back period for insider preferences), § 702 (excluding insiders from eligibility to vote on chapter 7 trustee); see also In re Tidal Constr. Co., 446 B.R. 620, 624 (Bankr. S.D. Ga. 2009) (applying heightened scrutiny to transactions with insiders); In re Alaska Fishing Adventure, LLC, 594 B.R. 883, 887 (Bankr. D. Alaska 2018) (applying heightened scrutiny to transactions between chapter 7 trustee and insiders). Although the Court could venture deep into the rabbit hole discussing the potential impacts on these sections, ¹⁴ the Court is satisfied to stop with a brief discussion of § 727(a), which provides:

The Court shall grant debtor a discharge unless—... the debtor has committed any act specified in paragraph (2),

(3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider.

11 U.S.C. § 727(a)(7). If a business owner ceases to be an affiliate of a debtor in chapter 7, then that owner might be able to carry out any of the actions prohibited by § 727(a)(2) – (6) without the repercussions created in § 727(a)(7), so long as that owner does not otherwise fall under the definition of an insider. Perhaps there is a way to read this section and the definition of insider to ensure that Carter's proposed definition of affiliate never creates an issue in this respect, but the Court declines to engage in such intellectual gymnastics.

It *might* be true that the Court's concerns are mitigated relative to *some* provisions by the fact that affiliate or insider status is often measured from a historical perspective, i.e., prior to the chapter 7 case. For example, § 547 applies a longer look back period to transfers to insiders if the creditor was an insider as of the date of the transfer, which would always be pre-petition as between a debtor and its insiders. But relying on this temporal limitation is incomplete because (1) it ignores the post-petition activities of co-owners or co-affiliates of a chapter 7 debtor and how those transactions might be analyzed in subsequent bankruptcy cases of the co-owners; and (2) might require courts to fashion two definitions of affiliate—one that stops on the petition date and one that does not.

*7 Finally, the Court will address the policy concerns raised by Carter and other interested parties: excluding an otherwise eligible debtor from Subchapter V because of an old chapter 7 case. On first blush, the Court shared some concern over this issue, but having considered it more fully, the Court's concern has lessened. A primary reason some might view the Court's ruling as unsatisfying is the age of the D&N and CBSS cases. If the cases were five days old when Carter filed his petition, instead of five years, the Court doubts its ruling would raise an eyebrow, or that Carter would even make the argument. What if it were five weeks, or five months? Where should the line be drawn? Is there a principled way to draw such a line? If there is, the Court does not believe it is by deeming chapter 7 debtors and their owners not to be affiliates the instant a trustee is appointed, and Carter offers no other method to analyze when affiliation might otherwise terminate during a chapter 7 case.

The Court also is not convinced that owners of chapter 7 debtors with liabilities exceeding the Subchapter V debt limit are the type of small business debtors for whom

Subchapter V was designed, or that excluding those owners from Subchapter V while their businesses are liquidated in chapter 7 is inherently unfair, even if the chapter 7 business cases take longer to administer than expected. In the Court's experience, the time it takes to administer a chapter 7 estate generally correlates directly to the size and complexity of the debtor's capital structure, and it is not surprising that larger corporate chapter 7 cases may take years for a trustee to administer. It is also not unreasonable to expect that business owners often will have capital structures, so to speak, that correlate in size and complexity to their business ventures. Business owners often share joint and several liability on many corporate debts, and an owner's bankruptcy case will often have many legal and factual issues that overlap with a business case in chapter 7.15 The Court is not convinced that the specific facts of this case are likely to be all that common, and even if they occur occasionally, there is nothing inherently unfair about it. Carter is not being locked out of bankruptcy, or even chapter 11, just Subchapter V.

Carter's counsel indicated at the Subchapter V status conference that Carter filed this bankruptcy case largely because of state court litigation against him by Matthew Armstrong, a co-owner of D&N, and one of the largest creditors of D&N (based on filed proofs of claims). Armstrong's state court litigation, attached to his proof of claim of record in this case, asserts claims against Carter based on, among other things, alleged breaches of fiduciary duty related to a lease by D&N of property owned by a different non-debtor entity also co-owned by Armstrong and Carter. The Court makes no findings relative to Armstrong's claims and points to these issues only to make the point that D&N continues to loom large in Carter's own financial affairs.

Thus, the Court is not convinced, even from a pure policy perspective, that Carter is right when he argues that the affiliated group of debtors under § 1182 is meant to capture only those debtors that remain under common control during their bankruptcy cases. Even if that were the intent, the statute goes about it in a rather odd way. The plain language of § 1182 provides that the aggregate liabilities of affiliated debtors under title 11 are to be considered when determining Subchapter V eligibility. The Court is not persuaded that chapter 7 debtors were meant to be excluded from that affiliated group through the interpretation of "voting securities" proposed by Carter. The Court finds that Carter owned more than 20% of the voting securities of D&N and CBSS when he filed his chapter 11 case, and together they are

a group of affiliated debtors under title 11 for purposes of § 1182

C. The Aggregate Liabilities of Carter and D&N Exceeded \$7.5 million on the Petition Date.

*8 Carter argues that even if he is an affiliate of D&N and CBSS, their aggregate, non-duplicate, non-insider, noncontingent, liquidated liabilities do not exceed \$7,500,000. To get there, he contends the Court should consider only the debtors' filed schedules in all three cases when determining the amount of liabilities. The Court rejects this proposition. Although a debtor's schedules provide probative value, the Court will not confine its inquiry solely to the schedules. *In re Hall*, 650 B.R. 595, 600 (Bankr. M.D. Fla. 2023) (citing *In re Steffens*, 343 B.R. 696, 698 (Bankr. M.D. Fla. 2005)). A debtor's eligibility is determined by what the debtors owe on the petition date, not by what the debtors think they owe. *In re Hall*, 650 B.R. at 600 (citing *In re Sullivan*, 245 B.R. 416, 418 (Bankr. N.D. Fla. 1999)).

The filed proofs of claim in D&N exceed \$51,767,569.82, and although some of those claims may belong to insiders or are contingent or unliquidated, the IRS filed a proof of claim for more than \$28 million. See Claim 11-4, D&N case. That claim has been filed of record since 2018, ¹⁶ and no objection, withdrawal, or settlement of that claim appears on the record in the D&N case. Carter makes no argument related to the IRS claim against D&N other than his blanket assertion that no proofs of claim should be considered in the D&N case because the trustee in that case has indicated there will be no claims resolution process as the estate is administratively insolvent. Carter offers no authority supporting this contention, and the Court is not convinced it should blindly ignore millions of dollars of filed claims.

The claim was amended several times, with the last amendment filed in November of 2018. Although the original proof of claim was filed in an amount less than \$1 million, the first amended claim asserted more than \$13 million, the second amended claim asserted more than \$11 million, and the final amendment asserts more than \$28 million. See Claim Nos. 11-1, 11-2, 11-3, and 11-4, D&N case.

Even if the Court were to accept that premise, the same logic does not hold true for Carter's case, and the IRS filed a proof of claim in his case for \$4,657,938.64.¹⁷ If the Court considers only the IRS's filed claim in Carter's case and D&N's scheduled liabilities that were not scheduled

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as contingent or unliquidated (\$2,966,136), ¹⁸ the total still exceeds \$7.5 million.

- The IRS amended its proof of claim three times, and the Court relies on the most recent amendment filed November 17, 2023. The original proof of claim asserted a claim of \$4,688,166.79. All three of the amendments exceed \$4.6 million in amount.
- The Court calculated this number from its own review of the D&N schedules. Both Carter and the U.S. Trustee asserted a larger number in their papers.

Although Carter scheduled the IRS as a disputed debt in his case in the amount of \$2,562,609.23, the plain language of \$ 1182 does not exclude disputed debts, only contingent and unliquidated debts. See In re Hall, 650 B.R. at 598-99. Further, Carter makes no effort to address the IRS's proof of claim in his briefing, has not filed an objection to the proof of claim, and offers no evidence or argument to rebut the presumption of its allowance or prima facie evidence of its validity. See 11 U.S.C. § 502(a); Fed. R. Bankr. P. 3001(f). The Court will not ignore these considerable debts to the IRS based on nothing more than a bare assertion that only the schedules matter. Carter bears the burden to establish eligibility, and he fails to offer any evidence or persuasive argument that the IRS's filed claims should be ignored in either case.

*9 Thus, if the Court considers only the IRS proof of claim in the D&N case, or alternatively considers only the IRS

proof of claim in Carter's case and the scheduled debts in D&N, the total exceeds \$7.5 million. This analysis ignores numerous other proofs of claim in D&N for millions of dollars. Therefore, without considering the additional debt of CBSS, the Court concludes that Carter failed to carry his burden of establishing that the combined debt of Carter and his affiliates do not exceed the \$7,500,000 debt limit, rendering him ineligible for Subchapter V.

III. CONCLUSION

If excluding debtors like Carter from Subchapter V was an unintended consequence of the affiliated-debtors language in § 1182, that is a problem better solved by Congress than this Court tampering with the definition of "affiliate" as proposed by Carter. Accordingly,

IT IS ORDERED that the United States Trustee's objection to Carter's eligibility under Subchapter V (Doc. No. 25) is sustained. Carter is not eligible to proceed under Subchapter V, and his election to do so is revoked. This case will proceed as a traditional chapter 11 case without reference to the Subchapter V provisions going forward.

IT IS ORDERED as set forth below: December 13, 2023

All Citations

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In re Asset Enhancement, Inc., 87 F.4th 1271 (2023)

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87 F.4th 1271 United States Court of Appeals, Eleventh Circuit.

IN RE: ASSET
ENHANCEMENT, INC., Debtor.
Robert A. Sweetapple, Plaintiff - Appellant,

v.

Asset Enhancement, Inc., Defendant - Appellee.

> No. 22-11389 | Filed: 12/05/2023

Synopsis

Background: After judgment debtor proceeded in state court action initiated prepetition by Chapter 11 debtor, requesting that the state court sanction debtor and reduce attorney fee award entered against judgment debtor to \$0, debtor filed motion for contempt for violation of automatic stay and for sanctions. The United States Bankruptcy Court for the Southern District of Florida found judgment debtor's counsel personally liable for violating the stay. The Bankruptcy Court denied counsel's motion for reconsideration, and later entered order awarding debtor attorney fees and costs incurred in connection with the motion for contempt. The United States District Court for the Southern District of Florida, No. 21-60777-CIV-SMITH, Rodney Smith, J., 2022 WL 1311113, dismissed counsel's appeal. Counsel appealed.

Holdings: The Court of Appeals, Rosenbaum, Circuit Judge, held that:

- [1] Court of Appeals would review de novo the District Court's determination that it lacked jurisdiction over counsel's appeal, and
- [2] Bankruptcy Court's contempt order did not become "final" for purposes of appeal until the Court issued its later order setting the amount of attorney fees to be awarded.

Vacated and remanded.

West Headnotes (18)

[1] Bankruptcy 🧼 Automatic Stay

Automatic stay is a fundamental protection that the Bankruptcy Code provides to debtors upon the filing of a bankruptcy case in most instances; it works to give debtors a breathing spell to attempt to reorganize or simply be relieved of the financial pressures that led to the bankruptcy. 11 U.S.C.A. § 362.

[2] Bankruptcy 🌦 Scope of review in general

In the bankruptcy context, the Court of Appeals sits as a second court of review; that role requires the Court of Appeals to examine independently the factual and legal determinations of the bankruptcy court and employ the same standards of review as the district court.

[3] Bankruptey — Conclusions of law; de novo review

Generally, the Court of Appeals reviews de novo legal conclusions by either the bankruptcy court or the district court.

[4] Bankruptcy 🕪 Clear error

Court of Appeals reviews bankruptcy court's findings of fact for clear error.

[5] Bankruptcy — Conclusions of law; de novo

Court of Appeals would review de novo the District Court's determination that it lacked jurisdiction over counsel's appeal from Bankruptcy Court's contempt order, finding counsel personally liable for violating the automatic stay. 11 U.S.C.A. § 362.

[6] Bankruptcy - Court of Appeals

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If the district court lacked jurisdiction over bankruptcy court's order, so does the Court of Appeals.

[7] Constitutional Law Pature and scope in general

Federal Courts ← Appellate Jurisdiction and Procedure in General

Court of Appeals is court of limited jurisdiction, and adjudicating appeal without jurisdiction would offend fundamental principles of separation of powers. U.S. Const. art. 3, § 1.

[8] Bankruptcy 🤛 Finality

"Final" decision, for purposes of appeal in bankruptcy proceeding, is one by which a district court disassociates itself from a case. 28 U.S.C.A. § 158(d)(1).

[9] Bankruptcy 🕪 Finality

"Final" decisions, for purposes of appeal in bankruptcy proceeding, end the litigation on the merits and leave nothing for the court to do but execute the judgment. 28 U.S.C.A. § 158(d)(1).

[10] Bankruptcy 🕪 Finality

Final-decision rule for appeal in bankruptcy context prevents piecemeal, prejudgment appeals that would undermine efficient judicial administration and encroach upon the prerogatives of trial judges. 28 U.S.C.A. § 158(d) (1).

[11] Bankruptcy 🕪 Finality

Rules about what qualifies as "final" for purposes of appeal are more flexible in bankruptcy because a bankruptcy case is an aggregation of individual controversies, many of which would exist as stand-alone lawsuits but for the bankrupt status of the debtor. 28 U.S.C.A. § 158(d)(1).

[12] Bankruptcy 🕪 Finality

Order in a bankruptcy case is "final" for purposes of appeal if the order finally disposes of discrete disputes within the larger case. 28 U.S.C.A. § 158(d)(1).

[13] Federal Courts > Fees and costs

Decision on the merits is a "final" decision, for purposes of statute governing federal appellate review of district court decisions, whether or not there remains for adjudication a request for attorney fees attributable to the case. 28 U.S.C.A. § 1291.

[14] Contempt 🌦 Decisions reviewable

Contempt decision does not become "final" for purposes of appeal until the contempt penalties imposed are no longer conditional or subject to modification; this rule aims to avoid the risk of disrupting a continuing, orderly course of proceedings below.

[15] Bankruptcy 🕪 Finality

Bankruptcy Court's contempt order, finding counsel personally liable for violating the automatic stay in corporate debtor's Chapter 11 case, did not become "final" for purposes of appeal until the Court issued its later order setting the amount of attorney fees to be awarded. 28 U.S.C.A. § 158(d)(1).

[16] Courts • Number of judges concurring in opinion, and opinion by divided court

Under prior-precedent rule, Court of Appeals must comply with its precedent unless en banc court or Supreme Court abrogates it.

[17] Courts Pumber of judges concurring in opinion, and opinion by divided court

For Supreme Court opinion to overrule Court of Appeals precedent, it must be clearly on point

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and actually abrogate or directly conflict with, as opposed to merely weaken, holding of prior panel.

[18] Courts Mumber of judges concurring in opinion, and opinion by divided court

Even if later panel is convinced prior one reached wrong result, for whatever reason, Court of Appeals must follow prior precedent.

*1273 Appeal from the United States District Court for the Southern District of Florida, D.C. Docket No. 0:21-cv-60777-RS, Bkcy No. 0:20-bk-15782-PDR

Attorneys and Law Firms

Douglas C. Broeker, Sweetapple Broeker & Varkas, PL, Miami, FL, for Plaintiff-Appellant.

Gary M. Murphree, AM Law LLC, Miami, FL, for Defendant-Appellee.

Before Rosenbaum, Branch, and Brasher, Circuit Judges.

Opinion

Rosenbaum, Circuit Judge:

*1274 Juliet was generally right that a rose by any other name smells as sweet. But Juliet's observation does not apply here.

1 See William Shakespeare, Romeo and Juliet act 2, sc. 2.

Depending on the name—or more specifically, the context—an order that leaves nothing to be determined in a proceeding but the amount of attorneys' fees to be awarded may or may not be a final, appealable order under our precedent. To be sure, most orders that resolve everything but the amount of attorneys' fees to be awarded qualify as final, appealable orders. But we've said that a contempt order that contemplates imposing attorneys' fees as a sanction for contempt but does not specify the amount of any such award is not a final, appealable order. Rather, the final order in that situation is the later order that awards the specific amount of fees. The earlier order that awards fees generally without indicating the

amount awarded then merges into the later order, and they both become appealable.

When we apply that rule here, we conclude that Plaintiff-Appellant Robert A. Sweetapple timely appealed the bankruptcy court's order finding him in contempt—even though the bankruptcy court entered that order more than fourteen days before Sweetapple appealed. Sweetapple's appeal was timely because he filed it within the fourteenday period following the bankruptcy court's entry of its order sanctioning Sweetapple with a specific amount of attorneys' fees for the contempt the bankruptcy court found in its earlier order. Because the district court reached the opposite conclusion, we vacate the district court's dismissal of this aspect of Sweetapple's appeal and remand for the district court to consider the appeal in the first instance.

I. BACKGROUND

This case has a somewhat long and messy history. It originates out of a Florida Public Records Act request that Asset Enhancement made to the Town of Gulfstream. After the Town of Gulfstream responded to that request in what Asset Enhancement deemed an incomplete and delayed way, in 2014, Asset Enhancement filed an action in Palm Beach Circuit Court against Gulfstream. Because of Gulfstream's alleged delay, Asset Enhancement argued, it was entitled to recover attorneys' fees and reasonable costs associated with enforcement of the record request.

Gulfstream and Asset Enhancement eventually settled the matter with final judgment entered against Gulfstream. But the parties left the amount of attorneys' fees and costs for the state court to determine. The state court held an evidentiary hearing on that matter and set final argument for May 28, 2020.

[1] A day before final argument occurred, though, Asset Enhancement filed its Chapter 11 bankruptcy petition. It then notified the state court of its bankruptcy filing and asked the state court to confirm that the May 28 hearing would not proceed because of the automatic stay.² Gulfstream's counsel emailed a legal memorandum to the state court, arguing that the automatic stay did not apply. After hearing arguments from both Gulfstream and Asset Enhancement, the state court concluded that Asset Enhancement's filing of its *1275 bankruptcy petition did not stay the attorneys' fees proceeding because Asset Enhancement, as the Debtor,

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initiated the action. So the state court held the May 28 hearing on the issue of attorneys' fees.

"The automatic stay is a fundamental protection" that the Bankruptcy Code "provide[s] to debtors upon the filing of a bankruptcy case in most instances. It works to give debtors a breathing spell to attempt to reorganize or simply be relieved of the financial pressures that led to the bankruptcy." *In re Cole*, 552 B.R. 903, 911 (Bankr. N.D. Ga. 2016).

Gulfstream, through its attorney (and now-Plaintiff-Appellant) Robert A. Sweetapple, argued that Asset Enhancement was not entitled to attorneys' fees for two reasons: (1) its fees resulted from an orchestrated scheme to abuse Florida's Public Records Act, and (2) in any case, its fees were unreasonable. Instead, Sweetapple asserted, the state court should sanction Asset Enhancement for its actions and reduce any attorneys' fees award to basically \$0. Despite its decision to proceed with arguments, the state court decided to wait to rule on the issue of attorneys' fees until the conclusion of the bankruptcy proceedings.

A. Bankruptcy Court Proceedings

Meanwhile, back in the bankruptcy court, about six weeks after the May 28 state-court hearing, Asset Enhancement filed its Amended Motion for Contempt for Violation of the Automatic Stay and For Sanctions ("Motion for Contempt"). According to Asset Enhancement, Gulfstream and Sweetapple violated the automatic stay by (1) convincing the state court to proceed with the May 28 hearing and (2) requesting sanctions against Asset Enhancement. As relief, Asset Enhancement sought damages for Gulfstream and Sweetapple's alleged willful violation of the automatic stay:

[Asset Enhancement] respectfully requests that this Court: (1) grant the Motion; (2) find that [Gulfstream] and Sweetapple knowingly and willfully violated the automatic stay in pursuing the sanctions claim and the setoff of the sanctions claim; (3) compel [Gulfstream] and Sweetapple to file with the trial court a complete waiver of any sanctions claim; (4) enter a monetary sanction against [Gulfstream] and Sweetapple for reasonable costs associated with filing and prosecuting this Motion; (5) enter an award of punitive damages against them joint and several; and (6) grant any further or additional relief as this Court deems necessary or appropriate.

Mot. for Contempt 8, Bankr. ECF No. 32.

The bankruptcy court granted Asset Enhancement's motion in part ("Contempt Order").

First, the bankruptcy court determined that the automatic stay applied to the state-court action even though Asset Enhancement instituted the action. That was so, the bankruptcy court reasoned, because Gulfstream sought offensive relief when it argued in support of sanctions against Asset Enhancement. Based on Gulfstream's efforts to obtain that relief in the state court, the bankruptcy court held that Gulfstream violated the automatic stay. And the bankruptcy court found Sweetapple, as Gulfstream's counsel, personally liable for violating the stay.

Then, the bankruptcy court addressed the remedies for the violation of the automatic stay. The court explained that because Asset Enhancement was a corporation, 11 U.S.C. § 105, which generally covers reorganizations involving corporations and partnerships and creates a statutory contempt power in bankruptcy proceedings, supplied the bankruptcy court's authority to award damages.

Next, the bankruptcy court considered each form of damages that Asset Enhancement requested. In so doing, the bankruptcy court held that Asset Enhancement was not entitled to compensatory damages because it did not put forth any evidence to support such damages. The bankruptcy court also declined to award injunctive relief, reasoning that the automatic stay, at bottom, is an injunction, so injunctive relief is neither necessary nor appropriate to *1276 protect the property of the estate. And as for punitive damages, the court concluded that Asset Enhancement wasn't entitled to them because the record indicated no type of egregious or malicious misconduct nor significant and foreseeable harm. But the bankruptcy court did award Asset Enhancement reasonable attorneys' fees and costs for the filing and prosecution of its Motion for Contempt.

Sweetapple timely moved for reconsideration of the bankruptcy court's Contempt Order. The bankruptcy court denied the motion ("Reconsideration Order").

Consistent with the Contempt Order, Asset Enhancement timely moved for specific attorneys' fees. And after the parties agreed to the amount of attorneys' fees, the bankruptcy court entered an order awarding Asset Enhancement \$12,931.50 for attorneys' fees and costs

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incurred in connection with the Motion for Contempt ("Fee Order").

Sweetapple and Gulfstream consented to the Fee Order on the amount of attorneys' fees and costs Asset Enhancement sought "solely" "to avoid the necessity of a contested hearing." Fee Order 2, Bankr. ECF No. 120. The Fee Order clarified that Sweetapple's consent to the order did not "constitute a waiver or admission as to any aspect of the Contempt Order and/or Order Denying Reconsideration. [The] Order [was] expressly entered without prejudice to [] Sweetapple's right to appeal any aspect of the Contempt Order and/or the Order Denying Reconsideration." *Id.*

After the bankruptcy court entered the Fee Order, Gulfstream paid Asset Enhancement's attorneys' fees.

B. District Court Proceedings

Sweetapple then filed his Notice of Appeal in the district court. In it, he challenged the Contempt Order, the Reconsideration Order, and the Fee Order. Asset Enhancement moved to dismiss Sweetapple's appeal for lack of jurisdiction.

The district court agreed and dismissed Sweetapple's appeal. First, the district court determined that it lacked jurisdiction to hear Sweetapple's appeal of the Contempt and Reconsideration Orders because the appeal was untimely. In support of that conclusion, the district court reasoned that these orders were final orders and were therefore immediately appealable, even though they left the amount of attorneys' fees unresolved. In reaching this conclusion, the court relied on Supreme Court precedent holding that the issue of attorneys' fees is collateral to the merits, and a decision on the merits is immediately appealable even if an issue as to the attorneys' fees remains unresolved.

And because the Bankruptcy Rules provide fourteen days to appeal from the entry of a final decision or order, and Sweetapple failed to appeal within that fourteen-day window from the entry of the Contempt and Reconsideration Orders, the district court ruled his appeal untimely. As a result, the district court concluded it lacked jurisdiction and dismissed the appeal.

Second, the district court concluded that Sweetapple lacked standing to challenge the Fee Order. Though Sweetapple had

timely filed the appeal of the Fee Order, the district court reasoned, he had consented to the entry of the Fee Order, so he could not, on appeal, challenge the fees awarded. The district court did identify one possible basis for an appeal of the Fee Order, though: if the award deviated from the parties' agreement. But Sweetapple did not allege that to be the case. So the district court dismissed Sweetapple's appeal of the Fee Order.

Sweetapple now appeals to us the dismissal of his appeal to the district court of *1277 his challenges to the Contempt and Reconsideration Orders.³

Sweetapple's Notice of Appeal also appeals the dismissal of the Fee Order. Sweetapple's briefing includes no argument challenging the district court's dismissal of his appeal of the Fee Order, though. As a result, Sweetapple has abandoned any challenge to the Fee Order. See Sapuppo v. Allstate Floridian Ins. Co., 739 F.3d 678, 680 (11th Cir. 2014). But even had Sweetapple not forfeited this issue, we would have affirmed. That's so because Sweetapple, through his consent to the Fee Order, waived any objection he otherwise may have had to the amount of fees that order awarded. So the district court correctly dismissed that appeal. See Hofmann v. De Marchena Kaluche & Asociados, 657 F.3d 1184, 1187 (11th Cir. 2011) ("As a general rule, a party has no standing to appeal an order or judgment to which he consented.").

II. STANDARD OF REVIEW

[2] [3] [4] In the bankruptcy context, we sit as a "second court of review." *In re Issac Leaseco, Inc.*, 389 F.3d 1205, 1209 (11th Cir. 2004) (quoting *In re Club Assoc.*, 951 F.2d 1223, 1228 (11th Cir. 1992)). That role requires us to "examine[] independently the factual and legal determinations of the bankruptcy court and employ[] the same standards of review as the district court." *Id.* Generally, we review de novo legal conclusions by either the bankruptcy court or the district court. *In re Fin. Federated Title & Tr., Inc.*, 309 F.3d 1325, 1328–29 (11th Cir. 2002). As for the bankruptcy court's findings of fact, we review those for clear error. *In re Optical Techs., Inc.*, 425 F.3d 1294, 1300 (11th Cir. 2005).

III. The district court had jurisdiction over Sweetapple's appeal of the contempt order.

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of review, concluded Sweetapple filed his appeal of the Contempt Order too late, so it lacked jurisdiction to consider the appeal. We review de novo the district court's determination that it lacked jurisdiction. If the district court lacked jurisdiction, so do we. And we must dismiss an appeal in those circumstances. After all, "we are a court of limited jurisdiction, [and] adjudicating an appeal without jurisdiction would 'offend[] fundamental principles of separation of powers.' " Corley v. Long-Lewis, Inc., 965 F.3d 1222, 1227 (11th Cir. 2020) (alteration in original) (quoting Steel Co. v. Citizens for a Better Env't, 523 U.S. 83, 94, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998)).

jurisdiction to hear appeals of "final decisions, judgments, orders, and decrees[.]" ⁴ 28 U.S.C. § 158(d)(1). As relevant here, a "final decision" is one "by which a district court disassociates itself from a case." Bullard v. Blue Hills Bank, 575 U.S. 496, 501, 135 S.Ct. 1686, 191 L.Ed.2d 621 (2015) (citation omitted). "Final decisions" "end[] the litigation on the merits and leave[] nothing for the court to do but execute the judgment." Budinich v. Becton Dickinson & Co., 486 U.S. 196, 199, 108 S.Ct. 1717, 100 L.Ed.2d 178 (1988) (citation omitted). The final-decision rule prevents "piecemeal, prejudgment appeals that would undermine efficient judicial administration and encroach upon the prerogatives of [trial] *1278 judges." Ritzen Grp., Inc. v. Jackson Masonry, LLC, — U.S. — -. 140 S. Ct. 582. 586, 205 L.Ed.2d 419 (2020) (cleaned up).

The rules about what qualifies as "final" are more flexible in bankruptcy because a bankruptcy case is " 'an aggregation of individual controversies,' many of which would exist as stand-alone lawsuits but for the bankrupt status of the debtor." Bullard v. Blue Hills Bank, 575 U.S. 496, 501, 135 S.Ct. 1686, 191 L.Ed.2d 621 (2015) (citation omitted). So an order in a bankruptcy case is "final" for purposes of § 158(d) (1) (and therefore immediately appealable) if the order "finally dispose[s] of discrete disputes within the larger case." Id. (citation omitted). The added flexibility in what constitutes a "final order" in bankruptcy (but not outside the bankruptcy context) does not factor into the analysis here, so we do not further discuss that flexibility.

That said, the Supreme Court has held that, for purposes of determining whether an order is a "final decision" under 28 U.S.C. § 1291 (the statute endowing courts of appeals with jurisdiction of appeals from all "final decisions of

[7] The district court, sitting as the first court the district courts"), an outstanding attorneys' fees issue does not preclude an otherwise-final decision from being a "final decision." Budinich, 486 U.S. at 202, 108 S.Ct. 1717. In reaching this conclusion, the Supreme Court expressly considered whether this rule should be different if the attorneys' fee issue might be considered part of the merits of the case. See id.

[13] It decided the rule should not. Id. As the Court explained, "[f]or all practical purposes an appeal of meritswithout-attorney's-fees when there is a statute deeming the attorney's fees to be part of the merits is no more harmful to the trial process than an appeal of merits-without-attorney'sfees when there is no such statute." Id. Plus, the Court [9] [10] [11] [12] In bankruptcy cases, we have asoned, having the time of appealability depend on whether attorneys' fees issues are viewed as part of the merits of the dispute or not in each case is confusing for litigants. See id. And because a wrong conclusion about whether an attorneys' fees issue is a merits or non-merits issue could have jurisdictional consequences, the Court concluded that "[c]ourts and litigants are best served by the bright-line rule." Id. So under Budinich, "a decision on the merits is a 'final decision' for purposes of § 1291 whether or not there remains for adjudication a request for attorney's fees attributable to the case." Id. at 202-03, 108 S.Ct. 1717.

> Several years later, the Supreme Court reaffirmed this rule in a different context. Ray Haluch Gravel Co. v. Cent. Pension Fund of Int'l Union of Operating Eng'rs and Emps., 571 U.S. 177, 134 S.Ct. 773, 187 L.Ed.2d 669 (2014). Budinich considered the issue in the statutory context. That is, *Budinich* held that an outstanding attorneys' fee issue didn't prevent a decision from being final when that decision awarded a litigant employment compensation under Colorado law, which provided that the judgment in such a suit "shall include a reasonable attorney fee in favor of the winning party, to be taxed as part of the costs of the action." 486 U.S. at 197, 108 S.Ct. 1717 (citation omitted).

> Ray Haluch, in contrast, considered the issue in the context of contractual damages. 571 U.S. at 184, 134 S.Ct. 773. There, the Court held that an unresolved attorneys' fee issue did not prevent a decision from being "final" even though attorneys' fees were part of the contract damages to be awarded. Id. at 184-85, 134 S.Ct. 773. As the Court emphasized, the rule was the same in both cases because the rule "did not depend on whether the statutory or decisional law authorizing a particular fee claim treated the fees as part of the merits." *Id.*

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at 185, 134 S.Ct. 773. Rather, the rule was a "uniform rule."

We can understand why the district court thought these cases supported the conclusion that the Contempt Order was a "final decision." After all, the Contempt Order left only the determination of attorneys' fees, so a straight-forward application of the "bright-line rule" from *Budinich* and *Ray Haluch* yields the conclusion that the Contempt Order was a "final decision." And, it might seem, so does the "uniform rule" reasoning underlying the Supreme Court's adoption of the *Budinich/Ray Haluch* rule.

- [14] But this is a contempt case. ⁵ And we have explained that a contempt decision *1279 does not become "final" until the contempt penalties imposed are no longer "conditional or subject to modification." *PlayNation Play Sys., Inc. v. Velex Corp.*, 939 F.3d 1205, 1212 (11th Cir. 2019) (citations omitted). This rule aims to avoid the "risk of disrupting a continuing, orderly course of proceedings below." *Combs v. Ryan's Coal Co., Inc.*, 785 F.2d 970, 976 (11th Cir. 1986) (citation omitted).
- Although we've recognized differences between the Bankruptcy Code's automatic stay and a court-ordered injunction, we've described the automatic stay as "essentially a court-ordered injunction." *Jove Eng'g, Inc. v. I.R.S.*, 92 F.3d 1539, 1546 (11th Cir. 1996) (citation omitted). And we've noted that "any person or entity who violates the stay may be found in contempt of court." *Id.* (citation omitted); *see also* 11 U.S.C. § 105(a).

And it finds its origins in Fox v. Capital Co., 299 U.S. 105, 57 S.Ct. 57, 81 L.Ed. 67 (1936). In Fox, the district court found Fox in contempt and entered an order that fined Fox (1) \$235,082.03 for his contempt and (2) an additional \$10,000 in attorneys' fees and costs. Id. at 106, 57 S.Ct. 57. Under the order, payment of the \$235,082.03—but not the \$10,000 in fees-would be remitted if Fox purged himself of his contempt. Id. at 106-07, 57 S.Ct. 57. Fox sought to appeal the entry of the \$10,000 fine, noting that it was not conditional. See id. at 108, 57 S.Ct. 57. But the Supreme Court held that the order in which the \$10,000 fine was set was not a final one. Id. at 109, 57 S.Ct. 57. That was so because when the district court issued the order, Fox could still purge his contempt and avoid paying the \$235,082.03. Id. at 108-09, 57 S.Ct. 57. In other words, the district court still had work to do in the case even after it issued the order. And the Court held that the controversy could not be "split" to render the \$10,000 fine its own final decision. See id.

Relying on our *Fox*-based precedent, in *PlayNation*, we considered a case in which the district court found parties in contempt and ordered them to pay attorneys' fees and expenses, without specifying the amount. 939 F.3d at 1209–10. In a later order, the district court established the amount of the award for fees and costs. *Id.* at 1210. We held that "there was no final decree until the amount of attorneys' fees and costs awarded as part of the [earlier] contempt order was set in the [later] order." *Id.* at 1212. When that happened, we explained, "the order containing the finding of contempt merged into the judgment and became subject to review on appeal." *Id.* (cleaned up). In other words, we effectively concluded that the contempt decision was "conditional or subject to modification" until the district court determined the amount of fees to be awarded. 6 *Id.*

- Nothing in the factual recitation in *PlayNation* suggests that the district court's decision to award fees itself was conditional or subject to modification, which might make the contempt order there seem like a "final" one if we were applying *Budinich*'s bright-line rule. But treating the contempt order as though it is not "final" when the only question left is the amount of fees to be awarded does promote "uniformity," or a "bright-line rule," in the context of contempt proceedings—even if that bright-line rule is the opposite of the one *Budinich* and its progeny espouse. And in any case, as we note above, we are bound by *PlayNation*, regardless.
- [15] Factually, Sweetapple's case is materially indistinguishable from *PlayNation*. In both cases, the court entered an order finding litigants in contempt and awarding attorneys' fees generally as a contempt sanction. Then, the court in each case waited to fix the amount of attorneys' fees to be paid until it issued a later order *1280 for that purpose. Because we held that the court's contempt decision in *PlayNation* did not become final until the court issued its later order setting the amount of attorneys' fees to be awarded, we must conclude the same thing here, on the same facts.
- In *PlayNation*, we considered whether the order there was "final" under § 1291, while here, we evaluate whether the order is "final" under § 158 because the contempt order at issue is a bankruptcy order. But that is a distinction without a difference in this case. After all, it is the nature of contempt, and not of bankruptcy, that drives the outcome here.
- [16] [17] [18] Our prior-precedent rule requires this result. Under our prior-precedent rule, we must comply with

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abrogates it. Sabal Trail Transmission, LLC v. 18.27 Acres of Land in Levy Cnty., 59 F.4th 1158, 1164 (11th Cir. 2023). For a Supreme Court opinion to overrule our precedent, it must be "clearly on point" and "actually abrogate or directly conflict with, as opposed to merely weaken, the holding of the prior panel." Id. (citations omitted). Even if a later panel "is convinced the prior one reached the wrong result —for whatever reason," we must follow the prior precedent. Id. (citation omitted). And here, we issued PlayNation after

the Supreme Court issued its decisions in Budinich and Ray

Haluch. That means PlayNation controls.

our precedent unless the en banc court or the Supreme Court

So long story, short: we hold that the Contempt Order did not become a final and appealable order until the bankruptcy court issued the Fee Order. Because Sweetapple filed his appeal within fourteen days of the bankruptcy court's issuance of the Fee Order, *see* Fed. R. Bankr. P. 8002(a)(1) ("[A] notice of appeal must be filed with the bankruptcy clerk within 14 days after entry of the judgment, order, or decree being appealed."), Sweetapple's appeal of the Contempt Order was timely. And the district court had jurisdiction over the appeal.

We therefore vacate the district court's dismissal of Sweetapple's appeal and remand for the district court in the first instance to consider the merits of Sweetapple's appeal.

IV. CONCLUSION

We vacate the district court's dismissal of Sweetapple's appeal of the Contempt Order as untimely because Sweetapple timely filed his appeal within fourteen days of the bankruptcy court's entry of the Fee Order, which rendered the Contempt Order final. And we remand Sweetapple's challenge to the bankruptcy court's Contempt Order to the district court for further proceedings consistent with this opinion.

VACATED AND REMANDED.

All Citations

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In re Ellingsworth Residential Community Association, Inc., 619 B.R. 519 (2020)

619 B.R. 519
United States Bankruptcy Court, M.D. Florida,
Orlando Division.

IN RE ELLINGSWORTH RESIDENTIAL COMMUNITY ASSOCIATION, INC., Debtor.

Case No. 6:20-bk-01346-KSJ | | Signed July 10, 2020

Synopsis

Background: Unsecured creditor objected that Chapter 11 debtor could not proceed under Subchapter V because, as non-profit community association, it did not engage in "commercial or business activities."

[Holding:] The Bankruptcy Court, Karen S. Jennemann, J., held that non-profit community association engaged in "commercial or business activities," as required for it to be a "small business debtor" eligible to file a Chapter 11 petition under Subchapter V.

Objection overruled.

West Headnotes (3)

[1] Bankruptcy • In general; nature and purpose

By encouraging small business reorganizations, Subchapter V of Chapter 11 seeks to promote greater distributions on creditor claims and the survival and prosperity of more small businesses.

[2] Bankruptcy Reorganization cases Bankruptcy Eleemosynary institutions

Any corporation that conducts commercial or business activities is a "small business debtor" potentially eligible to file a Chapter 11 case under Subchapter V; no profit motive is required. 11 U.S.C.A. §§ 101(51D)(A), 1182(1).

8 Cases that cite this headnote

[3] Bankruptcy ← Reorganization cases Bankruptcy ← Eleemosynary institutions

Non-profit community association engaged in "commercial or business activities," as required for it to be a "small business debtor" eligible to file a Chapter 11 petition under Subchapter V, by contracting for goods and services, hiring managers, lawyers, and other professionals, collecting regular and special assessments from its homeowners, overseeing common area property, and filing regular tax returns and listing business income. 11 U.S.C.A. §§ 101(51D)(A), 1182(1).

7 Cases that cite this headnote

Attorneys and Law Firms

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ORDER OVERRULING ALICE GUAN'S OBJECTION TO DEBTOR'S ELIGIBILITY UNDER SUBCHAPTER V

Karen S. Jennemann, United States Bankruptcy Judge

*520 An unsecured creditor, Alice Guan ("Guan"), contends the Debtor cannot proceed in this Subchapter V Chapter 11 case because, as a non-profit community association, it does not engage in commercial or business activities and, therefore, is not an eligible debtor. I will overrule the objection concluding the Debtor engages in commercial or business activities and otherwise fits the definition of a small business debtor as defined in 11 U.S.C. § 101(51D)(A).² Debtor can proceed with this Subchapter V Chapter 11 case.

Doc. No. 51. Debtor filed a Memorandum in Opposition.

Doc. No. 61. Debtor is a non-profit incorporated in the State of Florida. Debtor operates a Homeowners

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Association and its primary source of income is derived from the dues and assessments from its eighty homeowners. Doc. No. 14.

- All references to the Bankruptcy Code refer to 11 U.S.C. §§ 101 et. seq.
- [1] The Small Business Reorganization Act ("SBRA"), enacted in August 2019, became effective on February 19, 2020.³ It is commonly called Subchapter V because all of its provisions are contained in Subchapter V of Chapter 11 of the Bankruptcy Code.⁴ The new law was enacted to help small businesses reorganize by streamlining the cumbersome and often expensive process of a typical Chapter 11 reorganization case.⁵ The statutory hope is that by encouraging small business reorganizations more creditors will receive greater distributions and more small businesses will survive and prosper.
- 3 Small Business Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079 (2019).
- 4 §§ 1181 1195 of the Bankruptcy Code.
- 5 In re Ventura, 615 B.R. 1, 12 (Bankr. E.D. N.Y. 2020).

Many of the new procedures allow for a quick confirmation of a plan of reorganization. No disclosure statement is required.⁶ Strict timelines require parties to quickly move the case forward. And, by abrogating the "absolute priority rule" as to *unsecured* creditors, debtors may confirm a plan without creditor support and still retain property, even though unsecured creditors, such as Guan, are not paid in full.⁸

- 6 See § 1181(b) of the Bankruptcy Code.
- 7 § 1129(b)(2)(B) of the Bankruptcy Code.
- § 1191(b),(c) of the Bankruptcy Code.

Debtor filed this Chapter 11 case under Subchapter V on March 3, 2020. In her Objection, Guan argues that, because the Debtor, a non-profit business, has no commercial activities, it is not eligible to file a Chapter 11 case under Subchapter V. Section 1182(1) of the Bankruptcy Code limits those who can file a Subchapter V case to a "small business debtor." In turn, § 101(51D)(A) of the Bankruptcy Code defines a small business debtor as:

[A] person engaged in *commercial or business activities*...that has aggregate noncontingent liquidated secured and unsecured debts as of the date of *521 the

filing of the petition...in an amount not more \$2,725,625 [.]¹⁰

- 9 Doc. No. 1.
- 10 11 U.S.C. § 101(51D)(A); emphasis added. The Coronavirus Aid, Relief, and Economic Security Act, or CARES Act, enacted on March 27, 2020, temporarily increased the debt limit in to \$7,500,000. Here, this increase, even if applicable, is not relevant because the debts do not exceed \$2.7 million.

So, the crux is whether a non-profit community association—the Debtor—conducts sufficient "commercial or business activities" to qualify as a small business debtor. No statutory definition of "commercial or business activities" exists. And, legislative history to discern congressional intent is sparse. ¹¹ Statutory interpretation asks courts to presume the legislature "says in a statute what it means and means in a statute what it says there." ¹² And, if the plain language of the statute is unambiguous, the court's inquiry ends. ¹³

- 11 In re Wright, 2020 WL 2193240 at *3 (Bankr. D. S.C. 2020).
- 12 Connecticut National Bank v. Germain, 503 U.S. 249, 253-54, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992).
- 13 *Id.* at 254, 112 S.Ct. 1146.
- [2] Here, the Court finds the statute clear and unambiguous. Any corporation that conducts "commercial or business activities" is a small business debtor. No profit motive is required. The only statutory exclusion is a person whose primary business is owning a single parcel of real estate, which does not apply. The plain and unambiguous language of § 101(51D)(A) indicates a small business debtor may engage in a very inclusive range of commercial or business activities. The Court will presume the statute means exactly what it says.

 Other courts also have interpreted § 101(51D)(A) broadly. 14
- See In re Wright, 2020 WL 2193240 at *3 (Bankr. D. S.C. 2020)(holding that debtor was engaged in commercial or business activities by addressing residual business debt); In re Ventura, 615 B.R. 1, 22 (holding that debtor was engaged in commercial or business activities by operating a bed and breakfast in her home).

Congress could have chosen different terms or added other exclusions when drafting the SBRA but instead chose very broad language. Any person who conducts a business or

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commercial enterprise is a small business debtor. Perhaps, one can contrast this definition against the term "consumer debt," defined as "debt incurred by an individual primarily for a personal, family, or household purpose." This definition reveals that commercial or business activities consist of any activities **not** of a personal, family, or household nature connected with business operations. ¹⁶

- 15 11 U.S.C. 101(8).
- 16 See In re Ventura, 615 B.R. at 18-19 (Bankr. E.D. N.Y. 2020).

[3] Debtor engages in several commercial or business activities that fit this broad categorization. It contracts for goods and services and hires managers, lawyers, and other professionals. It oversees the common area property at the project, engaging landscaping help and maintenance professionals. It files regular tax returns and lists business income. It is registered with the State of Florida as a corporation. ¹⁷ It has a board of directors who make decisions. And, it collects regular and special assessments from its homeowners. These activities constitute business and commercial activities, not debts for personal, family, or household purposes.

17 See Doc. Nos. 15 and 21.

Guan argues the Debtor does not engage in any "commercial or business activities" because the Debtor lacks a profit *522 motive and that § 101(51D)(A) is ambiguous relying on dissimilar language in two other sections of the Bankruptcy Code—§ 303(a) and § 1112(c). 18 Both sections include this phrase: "a moneyed, business, or commercial corporation." Section 303(a) prohibits filing an involuntary bankruptcy against (among others) any corporation that is "not a moneyed, business, or commercial corporation." Section 1112(c) similarly limits the court's ability to convert to Chapter 7 a Chapter 11 case of a corporation that is "not a moneyed, business, or commercial corporation." This phrase aptly defines the type of corporation protected from an involuntary bankruptcy or forced conversion to a liquidating Chapter 7 case. And, at least one court has held that non-profit corporations cannot be forced into Chapter 7. 19

§ 303(a) provides an "involuntary case may be commenced only under chapter 7 or 11 of this title, and only against a person, except a farmer, family farmer, or a corporation that is not a moneyed, business, or commercial corporation, that may be a debtor under the chapter under which such a case is commenced." § 1112(c) provides "[t]he Court may not convert a case under this case under this chapter to a case under chapter 7 of this title if the debtor is a farmer or a corporation that is not a moneyed, business, or commercial corporation, unless the debtor requests such conversion."

See In re Mandalay Shores Assoc., 22 B.R. 202 (Bankr. M.D. Fla. 1982). The Bankruptcy Court for the Middle District of Florida surveyed existing case law to interpret the phrase "not a moneyed, business, or commercial corporation" in the context of § 1112(c). The Court found a non-profit, organized for the singular purpose of acquiring an apartment house, is included in the exception within § 1112(c) because it has no profit related motive and does not distribute any of its income to its members.

However, the phrase does not define the **actual activities** conducted by a corporation or limits a non-profit corporation from being a small business. Comparing the two phases is like comparing apples to oranges; they simply have different uses and meanings. Any corporation that conducts any "commercial or business activity" can be a small business debtor, whether they operate for profit or not. And, there are numerous examples of non-profit corporations filing Chapter 11 prior to the enactment of the SBRA.²⁰ That litigants cannot *forcibly* convert non-profit corporations into Chapter 7 or an involuntary bankruptcy does not preclude non-profit corporations from *voluntarily* filing a Subchapter V Chapter 11 case or qualifying as a small business debtor under SBRA.

See In re Charles Street African Methodist Episcopal Church of Boston, 478 B.R. 73 (Bankr. D. Mass. 2012)(non-profit religious corporation Chapter 11 debtor); In re National Heritage Foundation, Inc., 478 B.R. 216 (Bankr. E.D. Va. 2012)(non-profit public charity Chapter 11 debtor); In re Delta Transitional Home, 399 B.R. 654 (Bankr. E.D. Ark. 2009) (nonprofit corporation Chapter 11 debtor); In re Pleasantview Swimming Pool Ass'n, Inc., 2007 WL 1063014 (Bakr. D. Md. 2007)(non-profit operating neighborhood swimming pool Chapter 11 debtor); In re S.A.B.T.C. Townhouse Ass'n, Inc., 152 B.R. 1005 (Bankr. M.D. Fla. 1993)(non-profit homeowners' association Chapter 11 debtor): In re Titusville Country Club. 128 B.R. 396 (Bankr. W.D. Pa. 1991)(non-profit country club Chapter 11 debtor).

Guan incorrectly interprets § 101(51D)(A) to circumvent provisions of the SBRA that will limit her recovery, such as elimination of the absolute priority rule.²¹ Guan

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understandably is unhappy with the new provisions of Subchapter V. They may limit how much she receives on her claim. Her dissatisfaction is not justification, however, to limit the otherwise broad, unambiguous definition of who qualifies as a small business debtor under *523 § 101(51D)(A). Just because Guan does not like the new law does not make the Debtor ineligible for relief under Subchapter V.

21 See 11 U.S.C. 1181(a).

Accordingly, it is

ORDERED:

- 1. Guan's Objection (Doc. No. 51) is **OVERRULED**.
- 2. Debtor qualifies as a small business debtor and is eligible to proceed with this Subchapter V Chapter 11 case.

All Citations

619 B.R. 519

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In re Hot'z Power Wash, Inc., 655 B.R. 107 (2023)

655 B.R. 107 United States Bankruptcy Court, S.D. Texas, Houston Division.

IN RE: HOT'Z POWER WASH, INC., Debtor.

CASE NO: 23-30749

Signed November 7, 2023

Synopsis

Background: Chapter 11 debtor sought confirmation of its proposed fifth amended Subchapter V plan of reorganization. United States Trustee (UST) objected to consensual confirmation.

Holdings: The Bankruptcy Court, Eduardo V. Rodriguez, Chief Judge, held that:

- [1] the bankruptcy rule governing the proper form of acceptance or rejection of a Chapter 11 plan applies in Subchapter V proceedings;
- [2] debtor's use of notice on face of plan to deem nonvoting creditors as having accepted the plan violated the subject rule;
- [3] debtor's treatment of nonvoting impaired creditor class as having implicitly accepted the plan violated the subsection of the Bankruptcy Code providing that a Chapter 11 plan can only be confirmed if, with respect to each class of claims or interests, such class has accepted the plan;
- [4] a nonvoting impaired creditor class should not be counted, for purposes of determining acceptance of a Subchapter V plan; and
- [5] because both voting impaired classes voted to accept the plan, debtor's proposed plan could be confirmed.

Objections sustained in part and overruled in part; plan confirmed.

West Headnotes (11)

[1] Bankruptcy 🕪 In General; The Case

Bankruptcy court may only hear a case in which venue is proper. 28 U.S.C.A. § 1408.

[2] Bankruptcy Consent to or Waiver of Objections to Jurisdiction or Venue

Bankruptcy Submission to district court for judgment

While bankruptcy judges can issue final orders and judgments for core proceedings, absent consent, they can only issue reports and recommendations on non-core matters. 28 U.S.C.A. §§ 157(b)(1), 157(c)(1).

[3] Bankruptcy — Consent to or Waiver of Objections to Jurisdiction or Venue

Bankruptcy court has constitutional authority to enter a final order where the parties have consented, impliedly if not explicitly, to adjudication of matter by the court. 28 U.S.C.A. § 157.

[4] Bankruptcy Consent to or Waiver of Objections to Jurisdiction or Venue

Bankruptcy Court had constitutional authority to enter a final order where the parties had engaged in motion practice in front of the Court and had never objected to the Court's constitutional authority to enter a final order or judgment in the case, thereby impliedly consenting to adjudication of the matter by the Court. 28 U.S.C.A. § 157.

[5] Bankruptcy Pacceptance

Bankruptcy rule governing the proper form of acceptance or rejection of a Chapter 11 plan applies in proceedings under Subchapter V of Chapter 11; the rule is one of general applicability. Fed. R. Bankr. P. 3018(c).

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[6] Bankruptcy ← "Deemed" acceptance; unimpaired classes

Use by Subchapter V Chapter 11 debtor of notice on face of its plan to deem nonvoting creditors as having accepted the plan violated the bankruptcy rule governing the proper form of acceptance or rejection of a Chapter 11 plan; under the Bankruptcy Code, impaired class's failure to cast a written vote did not constitute acceptance of the plan. 11 U.S.C.A. § 1126(c); Fed. R. Bankr. P. 3018(c).

[7] Bankruptcy • "Deemed" acceptance; unimpaired classes

Subchapter V Chapter 11 debtor's treatment of nonvoting impaired creditor class as having implicitly accepted its plan violated the subsection of the Bankruptcy Code providing that a Chapter 11 plan can only be confirmed if, with respect to each impaired class of claims or interests, such class has accepted the plan; under the Code, impaired class's failure to cast a written vote did not constitute acceptance of the plan. 11 U.S.C.A. §§ 1126, 1129(a)(8), 1191(a); Fed. R. Bankr. P. 3018(c).

[8] Bankruptcy • "Deemed" acceptance; unimpaired classes

Under the Bankruptcy Code, a nonvote by an impaired creditor class cannot be construed as acceptance of a Chapter 11 plan. 11 U.S.C.A. § 1126(c).

[9] Bankruptcy • "Deemed" acceptance; unimpaired classes

A nonvoting impaired creditor class should not be treated as having implicitly accepted or rejected a Subchapter V Chapter 11 plan for confirmation purposes but, instead, should not be counted; Bankruptcy Code is silent on correct treatment of a nonvoting class, acceptances and rejections must satisfy formality requirements set forth in bankruptcy rule governing proper form of acceptance or rejection of Chapter 11 plans, treating nonvoters as rejecters would defeat policy goals of Subchapter V, and calculation mandated by Code subsection setting forth number and amount of votes necessary for plan to be deemed accepted, which requires number of accepting votes to be divided by total votes cast in class, creates a mathematically undefined result that is absurd when applied to a nonvoting class, thus leaving court with one option, namely, to ignore a nonvoting class, which contravenes neither Code nor rules and is supported by legislative history of subsection. 11 U.S.C.A. §§ 1126, 1126(c), 1129(a)(8), 1191(a); Fed. R. Bankr. P. 3018(c).

[10] Bankruptcy 🌦 Acceptance

To be counted, acceptances and rejections of a proposed Chapter 11 plan must satisfy the formality requirements set forth in the bankruptcy rule governing the proper form of acceptance or rejection of Chapter 11 plans. 11 U.S.C.A. §§ 1126(c), 1129(a)(8); Fed. R. Bankr. P. 3018(c).

[11] Bankruptcy Eligibility to vote; impairment

Debtor's proposed fifth amended Subchapter V plan of reorganization satisfied the requirement that a Chapter 11 plan can only be confirmed if, with respect to each impaired class of claims or interests, such class has accepted the plan, where the plan contained three impaired classes, two of the impaired classes voted to accept the plan, and one impaired class did not vote; the nonvoting impaired class would not be counted. 11 U.S.C.A. §§ 1129(a)(8), 1191(a).

Attorneys and Law Firms

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Christopher Ross Travis, Office of the United States Trustee, Houston, TX, for U.S. Trustee.

MEMORANDUM OPINION

Eduardo V. Rodriguez, Chief United States Bankruptcy Judge

In this subchapter V proceeding, Hot'z Power Wash, Inc. seeks confirmation of its proposed Subchapter V plan pursuant to 11 U.S.C. § 1191(a). Hot'z Power Wash, Inc.'s proposed subchapter V plan contains three impaired classes. Two impaired classes voted to accept the plan and one class did not vote. The United States Trustee raised two objections to consensual confirmation under § 1191(a), to wit: (1) Hot'z Power Wash, Inc.'s attempt to use a notice on the face of the plan to deem non-voting creditors as having accepted the plan violates Fed. R. Bankr. P. 3018(c) and (2) Hot'z Power Wash, Inc.'s alternative argument that the non-voting impaired class has implicitly accepted the plan contravenes § 1129(a)(8). On October 20, 2023, the Court held a final hearing on confirmation. For the reasons set forth infra, the Court finds that (1) the use of a notice on the face of the plan to deem non-voting creditors as having accepted the plan violates *110 Fed. R. Bankr. P. 3018(c), and (2) while treating a nonvoting impaired creditor class as having implicitly accepted the plan does violate § 1129(a)(8), the Court nonetheless holds that non-voting impaired creditor classes will not be counted for purposes of whether § 1129(a)(8) is satisfied. As such, the United States Trustee's objections are sustained in part and overruled in part, and Hot'z Power Wash, Inc.'s plan is confirmed under 11 U.S.C. § 1191(a).

I. Background

- On March 5, 2023, ("Petition Date") Hot'z Power Wash, Inc. ("Debtor") filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code¹ initiating the bankruptcy case² ("Bankruptcy case").
- 2. On March 7, 2023, Jarrod B. Martin was appointed as the Subchapter V trustee³ ("Subchapter V Trustee").
- On June 5, 2023, Debtor timely filed its, "Plan of Reorganization for Small Business under Subpart V Chapter 11" ("Plan").

- On July 3, 2023, the Internal Revenue Service ("IRS"), objected to confirmation of Debtor's plan.⁵
- 5. On July 3, 2023, Debtor filed its, "Debtor's First Amended Plan of Reorganization for Small Business Under Subpart V Chapter 11" ("First Amended Plan") and "Debtor's Second Amended Plan of Reorganization for Small Business Under Subpart V Chapter 11" ("Second Amended Plan").
- On July 7, 2023, the IRS filed its "Amended Objection to Confirmation of Plan" to Debtor's Second Amended Plan.
- On August 1, 2023, Debtor filed its, "Debtor's Third Amended Plan of Reorganization for Small Business Under Subpart V Chapter 11" ("Third Amended Plan").
- On September 12, 2023, Debtor filed its, "Debtor's Fourth Amended Plan of Reorganization for Small Business Under Subpart V Chapter 11", 10 ("Fourth Amended Plan").
- On September 18, 2023, IRS filed its, "Objection to Confirmation of Plan" ("IRS Objection") to Debtor's Fourth Amended Plan.
- 10. On October 2, 2023, Debtor filed its, "Fifth Amended Plan of Reorganization for Small Business Under Subpart V Chapter 11", "Fifth Amended Plan").
- 11. On October 3, 2023, the IRS withdrew its IRS Objection. ¹³
- 12. On October 13, 2023, the United States Trustee ("UST") filed its, "United States Trustee's Objections *111 to Debtor's Plan of Reorganization Dated October 2, 2023".
 14 ("UST's Objection").
- On October 19, 2023, Debtor filed its "Debtor's Response to United States Trustee's Objections to Debtor's Plan of Reorganization Dated October 2, 2023,"15
- 14. On October 19, 2023, the Subchapter V Trustee filed his, "Statement Regarding Plan Confirmation," ¹⁶ and "Amended Statement Regarding Plan Confirmation." ¹⁷

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- 15. On October 20, 2023, the Court held a hearing ("Hearing") on UST's Objections and confirmation of Debtor's Fifth Amended Plan. 18
- 1 Any reference to "Code" or "Bankruptcy Code" is a reference to the United States Bankruptcy Code, 11 U.S.C., or any section (i.e.§) thereof refers to the corresponding section in 11 U.S.C.
- 2 ECF No. 1.
- 3 ECF No. 5.
- 4 ECF No. 56.
- 5 ECF No. 68.
- 6 ECF No. 70.
- 7 ECF No. 71.
- 8 ECF No. 73.
- 9 ECF No. 87.
- 10
- ECF No. 92.

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- ECF No. 104
- ECF No. 110.
- 13 ECF No. 111.
- ECF No. 115.
- ECF No. 124.

ECF No. 125.

- 17 ECF No. 126.
- 18 October 20, 2023 Min. Entry.

II. Jurisdiction, Venue, and Constitutional Authority

This Court holds jurisdiction pursuant to 28 U.S.C. § 1334, which provides "the district courts shall have original and exclusive jurisdiction of all cases under title 11," and exercises its jurisdiction in accordance with Southern District of Texas General Order 2012-6.19 Section 157 allows a district court to "refer" all bankruptcy and related cases to the bankruptcy court, wherein the latter court will appropriately preside over the matter. ²⁰ This Court determines that pursuant to 28 U.S.C. § 157(b)(2)(A) and (L), this proceeding contains core matters, as it primarily involves proceedings concerning

the administration of Debtor's estate and plan confirmation.²¹ This proceeding is also core under the general "catch-all" language because a confirmation hearing can only arise in the context of a bankruptcy case.²²

- 19 In re: Order of Reference to Bankruptcy Judges, Gen. Order 2012-6 (S.D. Tex. May 24, 2012).
- 20 28 U.S.C. § 157(a); see also In re: Order of Reference to Bankruptcy Judges, Gen. Order 2012-6 (S.D. Tex. May 24, 2012).
- 21 See 11 U.S.C. § 157(b)(2)(A), (L).
- 22 See Southmark Corp. v. Coopers & Lybrand (In re Southmark Corp.), 163 F.3d 925, 930 (5th Cir. 1999) ("[A] proceeding is core under § 157 if it invokes a substantive right provided by title 11 or if it is a proceeding that, by its nature, could arise only in the context of a bankruptcy case.") (quoting Wood v. Wood (In re Wood), 825 F.2d 90, 97 (5th Cir. 1987)).
- [1] This Court may only hear a case in which venue is proper.²³ 28 U.S.C. § 1408 provides that "a case under title 11 may be commenced in the district court for the district— in which the domicile, residence, [or] principal place of business...have been located for one hundred and eighty days immediately preceding such commencement."²⁴ Debtor's principal place of business was in Pasadena, Texas within Harris County, 25 180 days immediately preceding the Petition Date, and therefore, venue of this proceeding is proper.²⁶
- 23 28 U.S.C. § 1408.
- 24 Id.
- 25 ECF No. 1.
- 26 28 U.S.C. § 1408.
- [3] [4] While bankruptcy judges can issue final orders and judgments for core proceedings, absent consent, they can only issue reports and recommendations on non-core matters.²⁷ Here, the confirmation *112 of a plan is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (L). As such, this Court concludes that the narrow limitation imposed by Stern does not prohibit this Court from entering a final order here. 28 Furthermore, this Court has constitutional authority to enter a final order because the parties have consented, impliedly if not explicitly, to adjudication of this

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matter by this Court.²⁹ The parties have engaged in motion practice in front of this Court and have never objected to this Court's constitutional authority to enter a final order or judgment in this case. These circumstances constitute implied consent. Thus, this Court wields the constitutional authority to enter a final order here.

- 27 See 28 U.S.C. §§ 157(b)(1), (c)(1); see also Stern v. Marshall, 564 U.S. 462, 480, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011); Wellness Int'l Network, Ltd. v. Sharif, 575 U.S. 665, 135 S. Ct. 1932, 1938–40, 191 L.Ed.2d 911 (2015).
- 28 See, e.g., Badami v. Sears (In re AFY, Inc.), 461 B.R. 541, 547-48 (8th Cir. BAP 2012) ("Unless and until the Supreme Court visits other provisions of Section 157(b)(2), we take the Supreme Court at its word and hold that the balance of the authority granted to bankruptcy judges by Congress in 28 U.S.C. § 157(b)(2) is constitutional."); see also Tanguy v. West (In re Davis), 538 F. App'x 440, 443 (5th Cir. 2013) ("[W]hile it is true that Stern invalidated 28 U.S.C. § 157(b)(2)(C) with respect to 'counterclaims by the estate against persons filing claims against the estate,' Stern expressly provides that its limited holding applies only in that 'one isolated respect' We decline to extend Stern's limited holding herein.") (citing Stern, 564 U.S. at 475, 503, 131 S.Ct. 2594).
- Wellness Int'l Network, Ltd. v. Sharif, 575 U.S. 665, 684, 135 S.Ct. 1932, 191 L.Ed.2d 911 (2015) ("Sharif contends that to the extent litigants may validly consent to adjudication by a bankruptcy court, such consent must be expressed. We disagree. Nothing in the Constitution requires that consent to adjudication by a bankruptcy court be express. Nor does the relevant statute, 28 U.S.C. § 157, mandate express consent").

III. Analysis

Pending before the Court are two matters: (A) UST's Objection to Debtor's Fifth Amended Plan³⁰ and (B) confirmation of Debtor's Fifth Amended Plan.³¹ Debtor seeks confirmation of its proposed Subchapter V plan pursuant to 11 U.S.C. § 1191(a).³² Debtor's proposed subchapter V plan contains three impaired classes.³³ Class 1 is a secured claim of SOS Capital, class 2 is a secured claim of the IRS, and class 3 consists of unsecured creditors.³⁴ Classes 1 and 3 voted to

accept the plan, and class two did not vote.³⁵ The Court will address each matter in turn.

- 30 ECF No. 115.
- 31 ECF No. 110.
- 32 ECF No. 110; ECF No. 124.
- 33 ECF No. 110 at 5-6.
- 34 *Id.*
- 35 ECF No. 110 at 3.

A. UST's Objections to Debtor's Fifth Amended Plan

The UST raises two objections to consensual confirmation of Debtor's Fifth Amended Plan, to wit: (1) Debtor's attempt to use a notice on the face of the plan to deem non-voting creditors as having accepted the plan violates Federal Rule of Bankruptcy Procedure ("Bankruptcy Rule") 3018(c) and (2) Debtor's alternative argument that the non-voting impaired class has implicitly accepted the plan contravenes § 1129(a) (8). The UST also objected, in the alternative, that Debtor's Fifth Amended Plan was not fair and equitable pursuant to § 1191(b) were the plan to be confirmed as a nonconsensual plan. Thowever, this objection was withdrawn at *113 the Hearing. The Court will consider each of UST's remaining objections in turn.

- 36 ECF No. 115.
- 37 ECF No. 115.
- October 20, 2023 Courtroom Hearing (Closing Argument).

1. Whether Debtor can use a notice on the face of the Fifth Amended Plan to deem non-voting creditors as having accepted the plan

UST contends that Debtor's use of a bolded disclaimer on the face of the plan to deem non-voting creditors as having accepted the plan contravenes Bankruptcy Rule 3018(c). ³⁹ Debtor contends that Bankruptcy Rule 3018(c) is inapplicable in Subchapter V because in a Subchapter V case only the debtor may file a plan and the language of Bankruptcy Rule 3018(c) contemplates non-debtor entities also filing plans, thus making it only applicable in traditional Chapter 11. ⁴⁰

39 ECF No. 115 at 2.

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40 ECF No. 124 at 3.

Bankruptcy Rule 3018(c) provides:

An acceptance or rejection shall be in writing, identify the plan or plans accepted or rejected, be signed by the creditor or equity security holder or an authorized agent, and conform to the appropriate Official Form. If more than one plan is transmitted pursuant to Rule 3017, an acceptance or rejection may be filed by each creditor or equity security holder for any number of plans transmitted and if acceptances are filed for more than one plan, the creditor or equity security holder may indicate a preference or preferences among the plans so accepted. 41

41 Fed. R. Bankr. P. 3018(c).

[5] First, the Court quickly dispenses with Debtor's argument that Bankruptcy Rule 3018(c) is inapplicable to Subchapter V proceedings. Bankruptcy Rule 3018 is a rule of general applicability and Debtor cites no authority for the proposition that it is inapplicable in Subchapter V.⁴² Furthermore, the plain language of the rule merely provides that an acceptance or rejection may be filed for each plan transmitted.⁴³ Multiple plans may be filed in Subchapter V even though only the Debtor may file a plan.⁴⁴ Thus, Debtor's argument is without merit.

- 42 See ECF No. 124 at 3.
- Fed. R. Bankr. P. 3018(c) ("If more than one plan is transmitted pursuant to Rule 3017....").
- See 11 U.S.C. 1193(a) ("The debtor may modify a plan at any time before confirmation...").
- [6] Next, the Court agrees with the UST that Bankruptcy Rule 3018(c) precludes the use of plan language to deem non-voting creditors as having accepted the plan. 45
- 45 ECF No. 115 at 2.

In *In re Bressler*, this Court concluded when analyzing the interplay between Bankruptcy Rule 3018(c) and § 1126(c) that failure to cast a written vote constitutes neither acceptance nor rejection of the plan, and "nonvotes do not satisfy the language of § 1126(c) and thus, do not count toward the numerosity requirements." Debtor's attempt to treat non-votes as having accepted the plan directly contravenes this holding. 47

- 46 Bressler, 2021 WL 126184, at *3, 2021 Bankr. LEXIS 64 at *7; In re Dernick, 624 B.R. 799 (Bankr. S.D. Tex. 2020).
- 47 Bressler, 2021 WL 126184, at *3, 2021 Bankr. LEXIS 64 at *7; see also 11 U.S.C. § 1126(c).

*114 Accordingly, the UST's objection that Debtor's attempt to use a notice on the face of the plan to deem non-voting creditors as having accepted the plan violates Bankruptcy Rule 3018(c) is sustained. The following language found on the first page of Debtor's Fifth Amended Plan, "If you do not vote, you will be deemed to have accepted the Plan," 48 is struck.

48 ECF No. 110 at p. 1.

The Court will next consider UST's objection that Debtor's alternative argument, that the non-voting impaired class has implicitly accepted the plan, contravenes § 1129(a)(8).

2. Whether treating a non-voting impaired class as having implicitly accepted the plan contravenes § 1129(a)(8)

[7] Next, UST asserts that Debtor's alternative argument, that the non-voting impaired class has implicitly accepted the plan, contravenes § 1129(a)(8). Pecifically, UST argues that the plain language of § 1129(a)(8) requires that every impaired class affirmatively vote to accept the plan. Debtor argues that a non-voting class should be deemed an implicit acceptance by that class. Debtor further contends that UST's argument is untenable because it entirely precludes the possibility of consensual confirmation pursuant to § 1191(a) in situations where an impaired creditor class fails to cast a ballot. Debtor further notes that UST's argument is even more inequitable in a situation such as here where Debtor was informed by the IRS that it has an internal policy of not voting on Chapter 11 plans. Debtor 11 plans.

- 49 ECF No. 115 at 1-2.
- 50 ECF No. 115 at 1-2.
- 51 ECF No. 124 at 3.
- 52 October 20, 2023 Courtroom Hearing (Closing Argument).

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Subchapter V plans may only be confirmed pursuant to § 1191(a) if all the requirements of § 1129(a), other than paragraph (15) are met. ⁵⁴ Section 1129(a)(8) provides, *inter alia*, that a plan can only be confirmed if "[w]ith respect to each class of claims or interests ... such class has accepted the plan. ⁵⁵ Section 1126 governs acceptance of a plan by a creditor, providing that the holder of a claim "may accept or reject a plan ⁵⁶ and Rule 3018(c) requires such acceptances or rejections to be in writing. ⁵⁷ Section 1126 also enumerates who may vote on a plan and the numerosity and debt thresholds that must be met for a class to accept a plan for purposes of § 1129(a)(8). ⁵⁸

- 54 11 U.S.C. § 1191(a).
- 55 11 U.S.C. § 1129(a)(8).
- 56 11 U.S.C. § 1126(a).
- 57 *In re Bressler*, 2021 WL 126184, at *2–3, 2023 Bankr. LEXIS 64, at *6 (Bankr. S.D. Tex. 2021).
- 58 *Bressler*, 2021 WL 126184, at *2–3, 2021 Bankr. LEXIS 64 at *6.

[8] As discussed *supra*, this Court held in *In re Bressler* that failure to cast a written vote constitutes neither acceptance nor rejection of the plan, and "nonvotes do not satisfy the language of § 1126(c) and thus, do not count toward the numerosity requirements." As such, Debtor's attempt to treat a non-voting class as having implicitly accepted the plan similarly also *115 contravenes this holding. However, while a nonvote cannot be construed as an acceptance, the Code is also silent on the correct treatment of a nonvoting class and this issue was not directly addressed in this Court's *Bressler* opinion.

- 59 *Id.* at 2021 WL 126184, 2021 Bankr. LEXIS 64 at *6-7.
- 60 *Id.*
- 61 *Id.* at *2–3, 2021 Bankr. LEXIS 64 at *6.
- [9] The treatment of a non-voting creditor class is an issue of significant disagreement amongst bankruptcy courts, even amongst those in this district. 62 Courts have generally followed one of three approaches when presented with a plan in which there is a non-voting impaired creditor class: (a)

a nonvoting class is deemed to have accepted the plan for purposes of $\S 1129(a)(8)$; 63 (b) a nonvoting class is deemed to have rejected the plan for purposes $\S 1129(a)(8)$; 64 and (c) a nonvoting class is not counted for purposes of $\S 1129(a)(8)$. The Court will consider each approach in turn.

- See e.g. In re Cypresswood Land Partners, I, 409
 B.R. 396, 430 (Bankr. S.D. Tex. 2009) (adopting the logic that non-voting creditors had consented to the debtor's plan and that their inaction amounted to a deemed acceptance); In re Castaneda, No. 09-50101, 2009 Bankr. LEXIS 3591, 2009 WL 3756569, at *2 (Bankr. S.D. Tex. Nov. 2, 2009) (adopting the logic that non-voting creditors were presumed to reject a debtor's plan).
- 63 In re Cypresswood Land Partners, I, 409 B.R. 396, 430 (Bankr. S.D. Tex. 2009).
- 64 *In re Castaneda*, No. 09-50101, 2009 Bankr. LEXIS 3591, 2009 WL 3756569, at *2 (Bankr. S.D. Tex. Nov. 2, 2009).
- 65 In re Franco's Paving LLC, 654 B.R. 107, 110 (Bankr. S.D. Tex. 2023).

a. Whether a nonvoting class should be treated as having accepted the plan

The Tenth Circuit in *In re Ruti-Sweetwater, Inc.* concluded that when no vote is cast in an impaired class that the class should be deemed to have implicitly accepted the plan. 66 Largely looking to congressional history, the court in *Ruti-Sweetwater* noted that the pre-1978 bankruptcy act expressly provided that a failure to vote was deemed a rejection of the plan. 67 This provision was removed when the Code was passed in 1978. 68 Thus, the court in *Ruti-Sweetwater* held that non-voting, non-objecting creditors will be deemed to have implicitly accepted the plan. 69 The court further reasoned that if it were to hold otherwise the debtor would be placed in the position of refuting hypothetical objections and both the debtor and bankruptcy court should not be burdened with hypothetical objections that apathetic or careless creditors do not advance themselves. 70

- 66 836 F.2d 1263 (10th Cir. 1988).
- 67 *Id.* at 1267.

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- 68 Id. at 1267; (citing H.R. Rep. No. 95-595, 95th Cong. 1st Sess. 410 (1977)).
- 69 *Id.*
- 70 *Heins v. Ruti-Sweetwater (In re Sweetwater)*, 57 B.R. 748, 750 (D. Utah 1985).

In *In re Cypresswood Land Partners*, a Southern District of Texas Bankruptcy Court adopted the Tenth Circuit's reasoning, finding that:

regarding non-voters as rejecters runs contrary to the Code's fundamental principle, and the language of section 1126(c), that only those actually voting be counted in determining whether a class has met the requirements, in number and amount, for acceptance or rejection of a plan, and subjects those who *116 care about the case to burdens (or worse) based on the inaction and disinterest of others ⁷¹

71 409 B.R. at 430; (quoting *In re Adelphia Comm. Corp.*, 368 B.R. 140, 161-62 (Bankr. S.D.N.Y. 2007)).

Although some courts have agreed with *Ruti-Sweetwater*, including a court in this district, most agree that a nonvote cannot be construed as an implicit acceptance. As discussed *supra*, and as discussed in greater detail in this Court's *Bressler* opinion, this Court also agrees that a nonvoting creditor class cannot be deemed to have implicitly accepted the plan. Notwithstanding the change in the law when the Code was enacted in 1978 as highlighted by the *Ruti-Sweetwater* court, the interplay between the language of § 1126, Bankruptcy Rule 3018(c), and the applicable congressional history as discussed in *Bressler* clearly prohibits treating a nonvoting class as accepting the plan. 74

- 72 See e.g., In re M. Long Arabians, 103 B.R. 211 (B.A.P. 9th Cir. 1989); see also In re Vita Corp., 358 B.R. 749, 751-52 (Bankr. C.D. Ill. 2007), aff'd, 380 B.R. 525, 528 (C.D. Ill. 2008); In re 7th Street and Beardsley P'ship, 181 B.R. 426 (Bankr. D. Ariz. 1994); In re Townco Realty, Inc., 18 C.B.C.2d 13, 81 B.R. 707 (Bankr. S.D. Fla. 1987) (section 1126(c) and Bankruptcy Rule 3018 require express acceptance).

74 See id.; (citing S. Rep. No. 95-989 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5909).

The Court will next consider if a nonvoting class should be treated as having rejected the plan.

b. Whether a nonvoting class should be treated as having rejected the plan

Among the courts that have rejected the holding of *Ruti-Sweetwater* and its progeny, the unanimous conclusion is that a Debtor is then unable to satisfy § 1129(a)(8) and must proceed with a cramdown pursuant to § 1129(b) or § 1191(b) as applicable.⁷⁵ The UST agrees with this approach.⁷⁶ In reaching this conclusion, courts frequently, without providing critical analysis, assume that a nonvote should be treated as a rejection for purposes of § 1126(c) thus resulting in a rejecting class for purposes of § 1129(a)(8).⁷⁷

- See e.g. In re M. Long Arabians, 103 B.R. 211 (B.A.P. 9th
 Cir. 1989); In re Higgins Slacks Co., 178 B.R. 853, 857
 (Bankr. N.D. Ala. 1995); In re Townco Realty, Inc., 18
 C.B.C.2d 13, 81 B.R. 707, 708 (Bankr. S.D. Fla. 1987).
- October 20, 2023 Courtroom Hearing (Closing Argument).
- See e.g., In re Friese, 103 B.R. 90, 92 (Bankr. S.D.N.Y. 1989); Bell Road Inv. Co. v. M. Long Arabians (In re M. Long Arabians), 103 B.R. 211, 216 (B.A.P. 9th Cir. 1989); In re Trenton Ridge Investors, LLC, 461 B.R. 440, 456–58 (Bankr. S.D. Ohio 2011); In re Vita Corp., 380 B.R. 525, 528 (C.D. III. 2008); In re Castaneda, 2009 WL 3756569, 2009 Bankr. LEXIS 3591 (Bankr. S.D. Tex. Nov. 2, 2009); In re 7th Street and Beardsley P'ship, 181 B.R. 426 (Bankr. D. Ariz. 1994); In re Townco Realty, Inc., 18 C.B.C.2d 13, 81 B.R. 707, 708 (Bankr. S.D. Fla. 1987); see also Castaneda, 2009 WL 3756569, at *3, 2009 Bankr. LEXIS 3591 at *7 ("an impaired creditor who does not vote is not deemed to have accepted a plan").

[10] This Court disagrees. As discussed *supra*, acceptances *and rejections* must satisfy the formality requirements in Bankruptcy Rule 3018(c) to be counted. Furthermore, as discussed in greater detail *infra*, the calculation mandated by § 1126(c) as applied to a nonvoting class creates a mathematically undefined result that cannot be construed as a rejection of the class. As such, the Court rejects the *117

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argument that a nonvoting class should be deemed to have rejected the plan.

- 78 Fed. R. Bankr. P. 3018(c).
- 79 See In re Franco's Paving LLC, 654 B.R. at 108–09.

The Court next considers whether a nonvoting class should not be counted for purposes of § 1129(a)(8).

c. Whether a nonvoting class can be ignored for purposes of § 1129(a)(8)

Recently, a Southern District of Texas Bankruptcy Court in *In re Franco's Paving LLC* concluded that a nonvoting class should not be counted for purposes of § 1126 and plan confirmation. ⁸⁰ Specifically, the court found that a nonvoting class renders the mathematical calculation required by § 1126(c) as impossible to calculate. ⁸¹ The court held that the indeterminate result obtained by dividing zero by zero was absurd and could not have been intended by Congress. ⁸² Analyzing the congressional history, the court concluded that when § 1126 was passed Congress presumed the existence of at least one vote in each class. ⁸³ The UST asserted in closing argument that the computation used in *Franco's Paving* is incorrect and § 1126(c) is determinate when no votes are cast in a class because the second prong of § 1126(c) fails, and therefore a rejection of the class can be inferred. ⁸⁴

- 80 *Id.*
- Id. ("the computation required under § 1126(c) is represented as follows: A/B > 50.00% where A = Number of claims in the class that vote for the plan B = Number of claims in the class that vote and C/D≥66.67% where C = Dollar amount of claims in the class that vote for the plan D = Dollar amount of claims in the class that vote...when no creditor votes, both computations become 0/0 = E (where E is simply the quotient) and when applying mathematical principles, E can be any number and is therefore indeterminate or undefined. Thus, the calculation cannot be performed...attempting to do what the laws of mathematics prohibit is an absurd proposition and could not have been intended when Congress enacted the current version of § 1126.").
- 82 *Id.*
- 83 *Id.* at 110.

Specifically, UST compared \$0 accepting with 1/2 of 0+0 and concluded that 0 accepting is not greater than a total of 0.

The Court rejects the equation offered by the UST. 85 The mathematical calculation required by § 1126(c) requires that the number of accepting votes be divided by total votes cast in a class. 86 As discussed, nonvotes are not counted pursuant to Bankruptcy Rule 3018(c). 87 Because nonvotes are not counted, a class of nonvotes results in the mathematical calculation of 0/0, an unsolvable and undefined quotient. 88

- UST's equation assumes that 0/0 becomes 0, however the result of that computation cannot be completed.
- 86 See e.g. In re Dernick, 624 B.R. 799, 814 (Bankr. S.D. Tex. 2020) (calculating a traditional voting class pursuant to § 1126(c)).
- See id.; In re Franco's Paving LLC, 654 B.R. at 109 n.2.

Furthermore, as discussed in *Bressler*, the legislative history of § 1126 provides:

A class of creditors has accepted a plan if at least twothirds in amount and more than one-half in number of the allowed claims of the class that are voted are cast in favor of the plan. The two-thirds and one-half requirements are based on a denominator that equals the amount or number of claims that have actually been voted for or against the plan, rather than the total number and amount of claims in the class, as under current chapter X.⁸⁹

- 89 2021 WL 126184, at *3, 2021 Bankr. LEXIS 64 at *7; (citing S. Rep. No. 95-989 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5909 (emphasis added)).
- *118 The equation utilized in *Franco's Paving* is derived from the same legislative history and supports this Court's prior holding in *Bressler*. 90 The Supreme Court has routinely held that the plain meaning of legislation should be conclusive unless literal application of a statute "is so bizarre that Congress could not have intended it." However, the Fifth Circuit has cautioned that courts must distinguish between "a result that is actually 'absurd'" and one that "is simply personally disagreeable." 92

In re Hot'z Power Wash, Inc., 655 B.R. 107 (2023)

- 90 654 B.R. at 109 n.1.
- Demarest v. Manspeaker, 498 U.S. 184, 190, 111 S.Ct. 599, 112 L.Ed.2d 608 (1991) (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571, 102 S.Ct. 3245, 73 L.Ed.2d 973 (1982)) (citations omitted); see also United States v. Rodriguez-Rios, 14 F.3d 1040, 1044 (5th Cir. 1994) (en banc) ("We are authorized to deviate from the literal language of a statute only if the plain language would lead to absurd results, or if such an interpretation would defeat the intent of Congress.").
- 92 *Johnson v. Sawyer*, 120 F.3d 1307, 1319 (5th Cir. 1997).

This Court concludes, similar to the court in *In re Franco's Paving LLC*, that the result of a § 1126(c) computation for a nonvoting class is absurd, unsolvable, and was not contemplated by Congress. Furthermore, as discussed *supra*, treating a nonvoting class as having implicitly accepted or rejected the plan is prohibited by the Code and applicable rules. House, since the application of the mathematical calculation in § 1126(c) is absurd as applied to a nonvoting class, and because the Code is silent on the correct treatment of a nonvoting class, this Court is left with only one option: when an impaired class of creditors fails to cast a ballot, that class will not be counted for purposes of whether § 1129(a) (8) is satisfied. House in the court of the counted for purposes of whether § 1129(a)

- 93 654 B.R. at 110.
- 94 11 U.S.C. § 1126(a); Fed. R. Bankr. P. 3018(c).
- While the Code does allow for a nonconsensual plan to be confirmed if creditor classes reject the plan, the Court cannot presume a rejection any more than it can presume an acceptance by a nonvoting class. Both outcomes directly contradict Bankruptcy Rule 3018(c) and § 1126(a) whereas alternatively, not counting a nonvoting creditor class does not contravene Bankruptcy Rule 3018(c) and is supported by the legislative history of § 1126(c).

Furthermore, were this Court to alternatively hold, as the UST suggests, that nonvoting classes of impaired creditors should be treated as having rejected the plan, not only would it contravene Bankruptcy Rule 3018(c) and § 1126(c) as discussed *supra*, it would run contrary to the policy goals behind Subchapter V.⁹⁶ Debtors and creditors alike would be forced to shoulder the additional administrative burdens and expenses associated with cramdown merely because a creditor class was negligent or apathetic about asserting their rights.⁹⁷ However, Congress clearly *119 articulated a

preference for consensual plans confirmed under § 1191(a). 98 Allowing creditors' silence to force nonconsensual plans, especially as is the case here where a non-voting class is willfully withholding its vote, defeats the overarching policy preferences of Subchapter V. 99

- In re Free Speech Sys., LLC, 649 B.R. 729, 734 (Bankr. S.D. Tex. 2023) ("Subchapter V is a streamlined chapter 11 process and a debtor has to work from the outset to try to achieve a consensual plan.").
- 97 In re Adelphia Communs. Corp., 368 B.R. 140, 261 (Bankr. S.D.N.Y. 2007) ("Regarding non-voters as rejecters runs contrary to the Code's fundamental principle, and the language of section 1126(c), that only those actually voting be counted in determining whether a class has met the requirements, in number and amount, for acceptance or rejection of a plan and subjects those who care about the case to burdens (or worse) based on the inaction and disinterest of others. A holding to the contrary would mean that a failure to vote isn't relevant in a case where anyone else in that class votes, but is enough to force cramdown if the lack of interest in that class is so extreme that nobody at all chooses to vote, one way or the other...a principle upon which the bankruptcy community often relies, as creditor democracy could otherwise be frozen as a consequence of the disinterest of others.").
- See 11 U.S.C. § 1183(b)(7) ("facilitate the development of a consensual plan"); In re Ozcelebi, 639 B.R. 365, 381 (Bankr. S.D. Tex. 2022) (this duty is "unique" to a subchapter V trustee).
- See 8 Collier on Bankruptcy P 1180.01 ("Small business enterprises historically have had difficulty reorganizing in chapter 11 for a number of reasons, including chapter 11's exorbitant administrative costs, hard to achieve confirmation requirements, and excessive creditor influence over the confirmation process. The Small Business Reorganization Act of 2019 enacted subchapter V of chapter 11 to govern reorganizations of eligible smaller businesses that elect its application to eliminate those obstacles [s]everal subchapter V provisions encourage consensual plans of reorganization."); but see § 1129(a)(10) (The Code contemplates at least one impaired vote must accept under § 1129(a)(10). If no class voted, § 1129(a)(10) could not be satisfied).

Accordingly, UST's objection to Debtor's alternative argument that a non-voting impaired class has implicitly accepted the plan contravenes § 1129(a)(8) is sustained, but

In re Hot'z Power Wash, Inc., 655 B.R. 107 (2023)

UST's overarching objection that Debtor's Fifth Amended Plan cannot be confirmed pursuant to § 1191(a) is overruled.

B. Confirmation of Debtor's Fifth Amended Plan

[11] On October 5, 2023, Debtor filed its Fifth Amended Plan and now seeks confirmation from this Court. 100 Under § 1191(a), a debtor must satisfy all of the requirements of § 1129(a) other than paragraph (15) of that section. 101 In accordance with the discussion *supra*, Class 2 did not vote, and as such will not be counted for purposes of § 1129(a) (8). 102 All other impaired classes voted to accept the plan. 103 Therefore § 1129(a)(8) is satisfied. 104 Furthermore, the Court finds that all other requirements pursuant to § 1191(a) have been satisfied.

100 ECF No. 110.

- 101 11 U.S.C. § 1191(a).
- See e.g., In re Franco's Paving LLC, 654 B.R. at 110.
- 103 ECF No. 120.
- 104 *In re Franco's Paving LLC*, 654 B.R. at 110.

Accordingly, the Court confirms the Debtor's plan pursuant to § 1191(a).

IV. Conclusion

An order consistent with this Memorandum Opinion will be entered on the docket simultaneously herewith.

All Citations

655 B.R. 107

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In re Franco's Paving LLC, 654 B.R. 107 (2023)

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654 B.R. 107 United States Bankruptcy Court, S.D. Texas, Corpus Christi Division.

IN RE: FRANCO'S PAVING LLC, Debtor.

Case No: 23-20069

Signed October 5, 2023

Synopsis

Background: United States Trustee objected to confirmation of debtor's proposed plan in Subchapter V Chapter 11 case.

[Holding:] The Bankruptcy Court, David R. Jones, J., held that creditor class in which no votes were cast on proposed plan would not be considered in determining whether plan could be confirmed as consensual.

Objection overruled; plan confirmed.

West Headnotes (6)

[1] Bankruptcy Particular proceedings or issues

Proceeding whereby United States Trustee objected to confirmation of debtor's proposed plan in Subchapter V Chapter 11 case, based on failure of all creditor classes to affirmatively accept the plan, was "core" matter, for purposes of bankruptcy jurisdiction. 28 U.S.C.A. § 157(b) (2)(A, L, O).

[2] Bankruptcy Consent to or Waiver of Objections to Jurisdiction or Venue

Bankruptcy Court had constitutional authority to enter a final order in proceeding whereby United States Trustee objected to confirmation of debtor's proposed plan in Subchapter V Chapter 11 case, based on failure of all creditor classes to affirmatively accept the plan, since parties had

impliedly consented to the entry of a final order. U.S. Const. art. 3, § 1.

[3] Bankruptcy 🤛 Construction and Operation

When faced with an unusual case, certainly not contemplated in the Bankruptcy Code, a court should read the statute to align with congressional intent and the statute's design.

[4] **Bankruptcy** Equitable powers and principles

Bankruptcy court is a court of equity, seeing to administer the law according to its spirit, and not merely by its letter.

[5] Bankruptcy • In general; nature and purpose

Subchapter V is intended to encourage consensual plans confirmed under Chapter 11. 11 U.S.C.A. § 1191(a).

[6] Bankruptcy • Acceptance

Creditor class in which no votes were cast on proposed plan in Subchapter V Chapter 11 case would not be considered in determining whether that plan could be confirmed as consensual. 11 U.S.C.A. §§ 1129(a)(8), 1191(a).

1 Case that cites this headnote

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MEMORANDUM OPINION

In re Franco's Paving LLC, 654 B.R. 107 (2023)

72 Bankr.Ct.Dec. 249

(Docket No. 72)

DAVID R. JONES, UNITED STATES BANKRUPTCY JUDGE

This case presents the question of how a court should view a class of creditors that fails to vote on a proposed plan in a subchapter V chapter 11 case for purposes of determining whether that plan may be confirmed under 11 U.S.C. § 1191(a). For the reasons set forth below, the Court finds that a creditor class in which no votes are cast will not be considered for purposes of 11 U.S.C. § 1129(a)(8). The *108 objection advanced by the United States Trustee is overruled, and the Debtor's plan is confirmed under 11 U.S.C. § 1191(a).

Relevant Factual Background

The Debtor filed a subchapter V chapter 11 case on March 17, 2023. [Docket No. 1]. The Debtor filed its proposed plan on June 15, 2023. [Docket No. 48]. The plan was subsequently amended on August 8, 2023, to address certain objections raised by creditors. [Docket No. 55].

The Debtor's plan contains six classes. [Docket No. 55]. Votes were cast in Classes 1, 3 and 4. [Docket No. 63]. All creditors that cast a ballot voted in favor of the Debtor's plan. [Docket No. 63]. No votes were cast in Classes 2, 4 and 5. [Docket No. 63]. Class 2 consists of the secured claim of the U.S. Small Business Administration ("SBA"). [Docket No. 55]. Class 5 consists of the priority unsecured claim of the Internal Revenue Service ("IRS"). [Docket No. 55]. Class 6 consists of the general unsecured claim of the IRS, the deficiency claim of the SBA and other unknown unsecured claims. [Docket No. 55].

The United States Trustee filed its objection on September 8, 2023. [Docket No. 61]. In his objection, the United States Trustee objected to confirmation of the plan (i) due to outstanding Monthly Operating Reports; (ii) on grounds of feasibility; and (iii) based on a perceived ambiguity in how distributions would be made. [Docket No. 61]. These objections were either satisfied or abandoned at confirmation. In his closing argument, however, the United States Trustee asserted that the Debtor's plan could not be confirmed under 11 U.S.C. § 1191(a) due to the failure of all classes to affirmatively accept the plan under 11 U.S.C. § 1129(a)(8) as required by 11 U.S.C. § 1191(a). In support of his position,

the United States Trustee relied on the decision rendered in *In re Bressler*, No. 20-31024, 2021 WL 126184 (Bankr. S.D. Tex. Jan. 13, 2021).

Jurisdiction and Authority

[1] [2] The Court has jurisdiction over this contested matter pursuant to 28 U.S.C. § 1334(b). This contested matter is a core proceeding under 28 U.S.C. §§ 157(b)(2)(A), (L) and (O). The Court has constitutional authority to enter a final order in this contested matter. *Stern v. Marshall*, 564 U.S. 462, 486–87, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). To the extent necessary, the parties have impliedly consented to the entry of a final order by the Court. *See Wellness Int'l Network*, *Ltd. v. Sharif*, 575 U.S. 665, 683–85, 135 S.Ct. 1932, 191 L.Ed.2d 911 (2015) (holding that a party impliedly consents to adjudication when the party "voluntarily appear[s] to try the case" with knowledge of the need for consent and without affirmatively refusing to provide it (quoting *Roell v. Withrow*, 538 U.S. 580, 590, 123 S.Ct. 1696, 155 L.Ed.2d 775 (2003))).

Analysis

Confirmation of a subchapter V chapter 11 plan is governed by 11 U.S.C. § 1191. Section 1191(a) provides that:

[t]he court shall confirm a plan under this subchapter only if all of the requirements of section 1129(a), other than paragraph (15) of that section, of this title are met.

11 U.S.C. § 1191(a). Section 1191(b) provides an exception to the requirements for confirmation under § 1191(a):

[I]f all of the applicable requirements of section 1129(a) of this title, other than paragraphs (8), (10), and (15) of that section, are met with respect to a plan, the court, on request of the debtor, shall confirm the plan notwithstanding the requirements of such paragraphs if the plan does not discriminate unfairly, and *109 is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

11 U.S.C. § 1191(b). Confirming a plan under § 1191(b) has certain implications for the debtor. Confirmation under § 1191(b) requires additional proof regarding the effects of the plan. 11 U.S.C. § 1191(b), (c) and (d). Other provisions of Subchapter V are likewise affected by confirmation under § 1191(b). *See* 11 U.S.C. § 1186 (expansion of property of the estate); 11 U.S.C. § 1192 (timing of discharge); 11 U.S.C.

In re Franco's Paving LLC, 654 B.R. 107 (2023)

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§ 1194(b) (designation of trustee as the default issuer of payments to creditors under a plan); 11 U.S.C. § 1193 (plan modification).

[3] [4] Section 1129(a)(8) provides, in part, that "[w]ith cast. respect to each class of claims or interests ... such class has accepted the plan." Section 1126 governs the acceptance of a plan by a creditor. The section provides that the holder of a claim "may accept or reject a plan." 11 U.S.C. § 1126(a). A "class of claims has accepted a plan if such plan has been accepted by creditors ... that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors ... that have accepted or rejected such plan." 11 U.S.C. § 1126(c). Therefore, the determination of acceptance or rejection requires the following mathematical computations 1:

$$A_{B} > 50.00\%$$

where A = Number of claims in the class that vote for the plan

B = Number of claims in the class that vote and

$$^{\rm C}/_{\rm D} \ge 66.67\%$$

where C = Dollar amount of claims in the class that vote for the plan

D = Dollar amount of claims in the class that vote The instant case raises the question of what occurs when no creditors in a class vote either to accept or to reject a plan. Mathematically, both computations become $^{0}/_{0} = E$ (where E is simply the quotient). Applying basic mathematical principles, one must calculate E such that $0 \times E = 0$. The obvious answer is that E can be any number and is therefore indeterminate or undefined.² In practical terms, the equation cannot be solved. Thus, the calculation required by § 1126(c) cannot be performed. When faced with an "unusual case, certainly not contemplated in the statute," a court should read the statute to align with congressional intent and "the statute's design." Truvillion v. King's Daughters Hosp., 614 F.2d 520, 527 (5th Cir. 1980). "A court of bankruptcy is a court of equity, seeing to administer the law according to its spirit, and not merely by its letter." Johnson v. Norris, 190 F. 459, 463 (5th Cir. 1911) (quoting In re Kane, 127 F. 552, 553 (7th Cir. 1904)). The Court finds that attempting to do what the laws of mathematics *110 prohibit is an absurd proposition

and could not have been intended when Congress enacted the current version of § 1126. By implementing a denominator that includes only votes actually cast in § 1126, it logically follows that Congress presumed that at least one vote was cast

- The legislative history of § 1126 specifies that "[a] class of creditors has accepted a plan if at least two-thirds in amount and more than one-half in number of the allowed claims of the class that are voted are cast in favor of the plan. The amount and number are computed on the basis of claims actually voted for or against the plan, not as under Chapter X on the basis of the allowed claims in the class." S. REP. NO. 95-989 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5909. Expressed slightly differently, the two-thirds and one-half requirements are based on a denominator that equals the number or amount of claims that have actually been voted either for or against the plan, rather than the total number and amount of claims in the class.
- For a general discussion, see "Division by Zero," WIKIMEDIA FOUND., https://en.wikipedia.org/wiki/Division_by_zero (last modified Sept. 27, 2023, 06:12).

The only circuit court to address this situation is the Tenth Circuit in In re Ruti-Sweetwater, Inc., 836 F.2d 1263 (10th Cir. 1988). In Ruti-Sweetwater, the Court noted the change from prior law that non-voting creditors were presumed to reject to the current law that deems such creditors bound by the decision of those creditors that vote. Id. at 1265-66. The Court concluded that in situations where no votes were cast in a class, it was required to determine whether "a failure to vote" is either an acceptance or a rejection. *Id.* at 1266. With this self-imposed limitation on the available choices, the Court held that by failing to cast a ballot, the non-voting creditors had consented to the debtor's plan and that their inaction amounted to a deemed acceptance. Id. at 1267-68. The Court noted that the Bankruptcy Code requires that creditors take an active role in protecting their claims. Id. at 1267. The Ruti-Sweetwater decision has been both adopted and criticized by courts in this circuit. See e.g., In re Cypresswood Land Partners, I, 409 B.R. 396, 430 (Bankr. S.D. Tex. 2009) (adopting the logic of Ruti-Sweetwater); In re Castaneda, No. 09-50101, 2009 WL 3756569, at *2 (Bankr. S.D. Tex. Nov. 2, 2009) (rejecting the logic of *Ruti-Sweetwater*).

[5] [6] The Court finds the policy underlying *Ruti-Sweetwater* compelling. The Court does not, however, believe that it is limited to the binary choice between a "deemed acceptance" and a "deemed rejection." Subchapter V is

In re Franco's Paving LLC, 654 B.R. 107 (2023)

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intended to encourage consensual plans confirmed under § 1191(a). *In re Free Speech Sys., LLC*, 649 B.R. 729, 734 (Bankr. S.D. Tex. 2023) ("Subchapter V is a streamlined chapter 11 process and a debtor has to work from the outset to try to achieve a consensual plan."). One of the subchapter V trustee's enumerated duties under § 1183 is to "facilitate the development of a consensual plan." 11 U.S.C. § 1183(b)(7); *In re Ozcelebi*, 639 B.R. 365, 381 (Bankr. S.D. Tex. 2022) (this duty is "unique" to a subchapter V trustee). From a practical perspective, a creditor that agrees to a debtor's plan may express its consent by affirmatively voting for a plan or by simply choosing not to file an objection. The outcome should be no different, as the overarching policy of Subchapter V is satisfied. The Court finds that in making the change to § 1126 when enacting the Bankruptcy Code, Congress presumed the

existence of at least one vote in each class. In a situation where no votes are cast, the Court holds that the class should not be counted for purposes of $\S 1129(a)(8)$.

To the extent that *In re Bressler*, No. 20-31024, 2021 WL 126184 (Bankr. S.D. Tex. Jan. 13, 2021) holds to the contrary, the Court respectfully disagrees and rejects its holding.

The Court therefore overrules the U.S. Trustee's objection and confirms the Debtor's plan pursuant to 11 U.S.C. § 1191(a).

All Citations

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In re Parking Management, Inc., 620 B.R. 544 (2020)

KeyCite Yellow Flag - Negative Treatment
Distinguished by In re Macedon Consulting, Inc., Bankr.E.D.Va., June 14,

620 B.R. 544
United States Bankruptcy Court, D. Maryland, at Greenbelt.

IN RE: PARKING
MANAGEMENT, INC., Debtor

Case No. 20-15026 | Signed August 28, 2020

Synopsis

Background: Dispute arose as to Chapter 11 debtor's eligibility to proceed on expedited basis under Subchapter V as small business debtor, or whether amount of its debt rendered it ineligible for such relief.

Holdings: The Bankruptcy Court, Thomas J. Catliota, J., held that:

- [1] lease rejection damages claims were contingent as of petition date and thus did not have to be included with debtor's other debt in assessing its eligibility for relief under Subchapter V, and
- [2] debtor's obligation on Paycheck Protection Program (PPP) funds that it had obtained was unliquidated on petition date, and thus did not have to be included with debtor's other debt in assessing its eligibility for relief under Subchapter V.

Ordered accordingly.

West Headnotes (17)

[1] Bankruptcy Particular proceedings or issues

Debtor's eligibility for a particular type of relief under the Bankruptcy Code is "core" question, which the bankruptcy court has both statutory and constitutional authority to finally decide. 28 U.S.C.A. § 157(b)(2)(A).

[2] Bankruptcy • In general; nature and purpose

Subchapter V of Chapter 11 was enacted to provide an expedited process for small business debtors to reorganize quickly, inexpensively, and efficiently. 11 U.S.C.A. § 1181 et seq.

1 Case that cites this headnote

[3] Bankruptcy Peorganization cases

In deciding whether amount of Chapter 11 debtor's liquidated, noncontingent debt was such as to render it ineligible for relief under Subchapter V as small business debtor, court did not have to find any lack of good faith or candor in order to look beyond the schedules filed by debtor and review the claims that had been filed in the case; in was enough that there was reasonable ground to doubt debtor's characterization of lease rejection damages and other claims as contingent and/or unliquidated as of petition date. 11 U.S.C.A. § 1182(1)(A).

[4] Bankruptcy Peorganization cases

In deciding whether amount of Chapter 11 debtor's liquidated, noncontingent debt was such as to render it ineligible for relief under Subchapter V as small business debtor, court had to assess debtor's secured and unsecured debt as of petition date. 11 U.S.C.A. § 1182(1)(A).

2 Cases that cite this headnote

[5] Bankruptcy 🕪 Construction and Operation

"Noncontingent debts," as that term is used in the Bankruptcy Code, are those where all events necessary to give rise to liability take place prepetition.

1 Case that cites this headnote

[6] Bankruptcy Peorganization cases

In re Parking Management, Inc., 620 B.R. 544 (2020)

Debt is deemed "contingent," and is thus not considered when assessing a Chapter 11 debtor's eligibility for relief under Subchapter V as small business debtor, if liability depends on a future extrinsic event which may never occur. 11 U.S.C.A. § 1182(1)(A).

4 Cases that cite this headnote

[7] Bankruptcy 🕪 Construction and Operation

"Contingent debts," as that term is used in the Bankruptcy Code, are a class of liabilities in which obligation to pay does not arise until the occurrence of a triggering event or occurrence reasonably contemplated by the debtor and creditor at time of occurrence of the event giving rise to the claim.

3 Cases that cite this headnote

[8] Bankruptcy Assumption, Rejection, or Assignment

Authority to reject an executory contract or unexpired lease is vital to the basic purpose of Chapter 11 reorganization, because rejection can release the estate from burdensome obligations that can impede a successful reorganization; similarly, the power to assume and/or assign an unexpired lease gives trustee significant flexibility in managing estate. 11 U.S.C.A. § 365(a).

[9] Bankruptcy • "Business judgment" test in general

Debtor's decision to reject an executory contract or unexpired lease is to be accorded the deference mandated by the "sound business judgment" rule as generally applied by courts to discretionary actions or decisions of corporate directors. 11 U.S.C.A. § 365(a).

[10] Bankruptcy Phase Necessity for court approval

Rejection of an executory contract or unexpired lease requires court approval, and is not a unilateral, independent process that can be accomplished by debtor alone. 11 U.S.C.A. § 365(a).

[11] Bankruptcy 🤛 Necessity for court approval

Requirement for court approval of debtor's decision to reject executory contract or unexpired lease is particularly important in the rejection of unexpired commercial leases. 11 U.S.C.A. § 365(a).

[12] Bankruptcy Effect of Acceptance or Rejection

Rejection or assumption of executory contract or unexpired lease by debtor does not determine whether the nondebtor party holds a claim; rather, it merely establishes the nature of any claim as either a prepetition obligation of debtor or as an administrative expense entitled to the highest priority. 11 U.S.C.A. §§ 365(g), 503(b).

[13] Bankruptcy ← Reorganization cases Bankruptcy ← Effect of Acceptance or Rejection

Lease rejection damages claims were contingent as of petition date and remained so until the issuance of bankruptcy court's order approving the rejections, and thus did not have to be included with Chapter 11 debtor's liquidated, noncontingent debts in assessing its eligibility for relief under Subchapter V as small business debtor; all of the events necessary to give rise to lease rejection damages claims had not occurred as of petition date. 11 U.S.C.A. §§ 365, 1182(1) (A).

2 Cases that cite this headnote

[14] Bankruptcy Peorganization cases

While some of Chapter 11 debtor's unexpired leases were ultimately rejected "as of petition date," once debtor's decision to reject leases was approved by bankruptcy court, this did not mean that bankruptcy court could consider lease rejection damages claim, which became

In re Parking Management, Inc., 620 B.R. 544 (2020)

noncontingent upon entry of bankruptcy court's order, when assessing debtor's eligibility for relief under Subchapter V as small business debtor; eligibility determination had to be made based on events existing on petition date, without regard to postpetition events. 11 U.S.C.A. § 1182(1)(A).

5 Cases that cite this headnote

[15] Bankruptcy Peorganization cases

Chapter 11 debtor's obligation on Paycheck Protection Program (PPP) funds that it had obtained under program created by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was unliquidated on petition date, and thus did not have to be included with debtor's other liquidated, noncontingent debt in assessing its eligibility for relief under Subchapter V as small business debtor; on petition date, it was not known whether debtor would ultimately have any obligation to repay these PPP funds. 11 U.S.C.A. § 1182(1)(A).

1 Case that cites this headnote

[16] Bankruptcy — Contingent or Unliquidated

Concept of a "liquidated debt," as that term is used in the Bankruptcy Code, relates to the amount of liability, not the existence of liability.

[17] Bankruptcy Contingent or Unliquidated Claims

Key factor in distinguishing "liquidated debts" from "unliquidated debts," as those terms are used in the Bankruptcy Code, is not the extent of the dispute nor the amount of evidence required to establish the debt, but whether the process for determining the debt is fixed, certain, or otherwise determined by a specific standard.

3 Cases that cite this headnote

Attorneys and Law Firms

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MEMORANDUM OF DECISION

THOMAS J. CATLIOTA, U.S. BANKRUPTCY JUDGE

*547 The new Subchapter V of Chapter 11 offers small business debtors a streamlined Chapter 11 procedure that is intended to be less costly and time-consuming than a traditional case. To be eligible for Subchapter V, a debtor must have "noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition ... in an amount not more than \$7,500,000." 11 U.S.C. § 1182(1)(A). The dispute before the court is whether the debtor Parking Management Inc. meets this eligibility test.

On the petition date, May 7, 2020, the debtor sought authority to reject 12 leases as of that date. The court approved the lease rejections by orders entered on May 21, 2020, authorizing the rejection of seven leases as of the petition date and five leases as of May 12, 2020. Creditor JBGS Management OP, L.P., ("JBGS") and John P. Fitzgerald, III, the Acting United States Trustee for Region 4 (the "UST"), joined by Union Investment Real Estate GmbH and 2201 Limited

In re Parking Management, Inc., 620 B.R. 544 (2020)

Partnership II and Connecticut/DeSales, LLC, contend the resulting lease rejection damages should be included in the eligibility determination.

Further, prior to the petition, the debtor obtained approximately \$1.8 million in funds under the Paycheck Protection Program (the "PPP") created by the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), Pub. L. No. 116-136, 134 Stat. 281 (2020). JBGS, but not the UST, contends the PPP obligation should be included in the debt limit determination.

If either the lease rejection claims or the PPP claim is included in the debt limit determination, the debtor would exceed the limit in § 1182. For the reasons stated below, the court concludes that the lease rejection claims were contingent as of the date of filing, and the PPP claim was contingent and unliquidated as of that date. Therefore, neither is included in the debt limit determination and the debtor is eligible to proceed under Subchapter V.

Jurisdiction

[1] The court has jurisdiction pursuant to 28 U.S.C. § 1334(a), § 157(a), and Local Rule 402 of the United States District Court for the District of Maryland. The resolution of the debtor's eligibility to qualify for a particular type of relief under the Bankruptcy Code is a statutorily core proceeding under 28 U.S.C. § 157(b)(2)(A), and a constitutionally core proceeding under the standards of *Stern v. Marshall*, 564 U.S. 462, 131 S. Ct. 2594, 180 L.Ed.2d 475 (2011).

Findings of Fact

Debtor filed for relief on May 7, 2020. On the petition, it designated itself a debtor "as defined in 11 U.S.C. § 1182(1), ¹ its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than \$7,500,000" and "it chooses to proceed under Subchapter V of Chapter 11." ECF 1 at p. 2 (emphasis eliminated).

Unless otherwise noted, all statutory references herein are to the Bankruptcy Code, 11 U.S.C. §§ 101 et seq., as currently in effect.

The debtor is one of the largest parking operators in the Mid-Atlantic area. As of April 30, 2020, it leased or managed approximately *548 100 parking facilities throughout the Northern Virginia, Washington D.C., and Baltimore, Maryland metropolitan areas, and employs 191 people. The debtor uses two basic structures for its parking operations. Under the first structure, the debtor leases a parking lot from a property owner, operates the parking facility, and pays rent to the owner. Under the second structure the debtor manages a parking facility for the property owner pursuant to a management agreement and receives a management fee as compensation for doing so. ECF 7 at ¶7-8.

Prior to the petition, the debtor determined it should reject twelve parking leases. On the petition date, it filed a motion to reject the leases as of that date. ECF 14. In the motion, the debtor stated it closed the facilities before the petition due to diminished revenues resulting from the COVID-19 pandemic and asked that it be allowed to reject the leases as of the petition date. After notice, no party objected to the rejection of the leases, but several landlords objected to the request to reject the leases as of the petition date. On May 21, 2020, the court issued two orders resolving the motion. Without objection by the pertinent landlords, the court authorized the rejection of seven of the leases "as of" the petition date. ECF 77. By agreement with landlords for five of the leases, the court authorized the rejection of the remaining leases as of May 12, 2020. ECF 75. Landlords representing five of the seven leases that were rejected as of the petition date have filed proofs of claim for the rejection damages in the aggregate amount of \$1,765,542.63. See Claim 27-1, Part 2 at p. 3; Claim 31-1, Part 2 at p. 3; Claim 32-1, Part 2 at p. 3.

Prior to the petition the debtor applied for small business funding under the PPP, and received \$1,862,723.84 on April 30, 2020, from Truist Bank. To evidence the PPP loan the debtor executed a Paycheck Protection Program Promissory Note in that amount. Proof of Claim 1-1, Part 2. The terms of the note are addressed further below.

The debtor and JBGS have been involved in an ongoing dispute during the case that is the subject of *JBGS Management OP, L.P. v. Parking Management, Inc.*, Adversary Proceeding No. 20-00195. There, it was established that the debtor and JBGS entered into a parking management agreement dated January 1, 2006, as subsequently amended, under which the debtor manages and operates 42 parking facilities on behalf of JBGS. The debtor collects parking revenue, pays certain authorized expenses, pays itself a management fee, and remits the net parking revenues to JBGS. JBGS contends that on the petition

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date, the debtor held \$2,803,376 of its net monthly parking revenues that the debtor failed to pay to it. In the adversary proceeding, it seeks the imposition of a constructive trust over the funds. As pertinent here, JBGS contends it holds a noncontingent, liquidated claim in that amount until its claim is satisfied.

The debtor filed its original schedules on May 20, 2020. ECF 69. It listed no secured claims on Schedule D, and \$6,169,500.01 of priority and unsecured claims on Schedule E/F. *Id.* at pp. 11-30. The debtor listed the JBGS claim as contingent in an "unknown" amount. *Id.* at p. 20. It included a claim of \$1,862,723.84 in favor of Truist Bank for "Paycheck Protection Program" that was not designated as contingent or unliquidated. *Id.* at p. 27. The debtor also listed unpaid prepetition rent claims due on its leases as of the petition date.

JBGS timely objected to the debtor's designation as a small business under Subchapter V, arguing that its claim was neither unknown nor contingent. ECF 114. It argued that if the debtor listed its claim on *549 the schedules as noncontingent and liquidated, the debtor would exceed the debt limits.

On July 8, 2020, the debtor filed amended schedules, again showing it was below the debt limits of § 1182. On Schedule D, it listed noncontingent liquidated secured claims of \$50,997.39. ECF 148 at pp. 6-8. On Schedule E/F, it listed total priority and unsecured claims of \$8,871,931.56, but that amount included the JBGS claim in the amount of \$2,655,942.11, which the debtor designated as contingent and disputed. Id. at p. 18. The amount also included the \$1,862,723.84 claim of Truist Bank, describing it as "Paycheck Protection Program (Grant)," also designated as contingent, unliquidated and disputed. Id. at p. 25. The debtor again included unpaid prepetition rent claims due on its leases as of the petition date and did not list lease rejection claims. The amended schedules led to further filings by the parties, ECF 161, 192, 193, 194, and 198, and the court held hearings on July 29, 2020, and August 12, 2020.

Conclusions of Law

The Small Business Reorganization Act, Pub. L. 116-54, 133 Stat. 1079 (Aug. 23, 2019) ("SBRA") "streamline[s] the bankruptcy process by which small business debtors reorganize and rehabilitate their financial affairs." H.R. Rep. No. 116-171, at p. 1 (2019),

available at https://www.congress.gov/116/crpt/hrpt171/ CRPT-116hrpt171.pdf. The SBRA created Subchapter V under Chapter 11 of the Bankruptcy Code to permit eligible small business debtors "to file bankruptcy in a timely, cost-effective manner." *Id.* at p. 4 (quoting statement of Rep. Ben Cline, the bill's sponsor, at a June 25, 2019 hearing).

The SBRA became effective on February 19, 2020. When enacted, Subchapter V was limited to debtors with no more than \$2,725,625 in noncontingent liquidated debts as of the date of the filing of the petition. In response to the COVID-19 pandemic, the President signed into law the CARES Act, which temporarily increased, until March 27, 2021, the Subchapter V debt limit to \$7,500,000.

The debtor filed this case after the enactment of the CARES Act. To be eligible for Subchapter V relief, the debtor's "aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition" can be "in an amount not more than \$7,500,000." § 1182(1)(A).² The debtor's amended Schedules D and E/F list total secured and unsecured debts of \$8,922.928.95. The amended schedules designated the \$1,862,723.84 of PPP funds as contingent and unliquidated, thus reducing the potential noncontingent and liquidated debts to below the debt limit. ECF 148. The amended schedules also do not list lease rejection claims. *Id.* Both the PPP funds and the lease rejection claims must be contingent and unliquidated as of the date of filing for the debtor to be eligible for Subchapter V.³

2 Section 1182 provides:

In this subchapter:

(1) Debtor .-- The term "debtor" ---

(A) subject to subparagraph (B) ... a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than \$7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor[.]

§ 1182(1)(A).

3

The debtor and JBGS dispute whether the JBGS claim is noncontingent and liquidated. Because the court concludes that the lease rejection claims and the PPP

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funds are contingent and unliquidated, it need not address this issue

*550 The court is not aware of any decisions addressing the eligibility requirements of § 1182. Many cases, however, have addressed similar eligibility debt limitation language under Chapters 12 and 13.⁴ The court begins by looking at these decisions for guidance.

4 Section 109(e) provides:

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than \$250,0002 and noncontingent, liquidated, secured debts of less than \$750,0002, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than \$250,0002 and noncontingent, liquidated, secured debts of less than \$750,0002 may be a debtor under chapter 13 of this title.

§ 109(e).

Although the Fourth Circuit has not addressed the question, many courts have recognized the need for an efficient, expedient resolution of the debt eligibility determination in Chapter 13 cases. In *Comprehensive Accounting Corp. v. Pearson (In re Pearson)*, 773 F.2d 751 (6th Cir. 1985), the court analogized the debt eligibility requirements of Chapter 13 to the amounts required for diversity jurisdiction under 28 U.S.C. § 1332:

[I]t is necessary that the procedures for determining initial jurisdiction cannot be allowed to dominate the proceedings themselves nor to delay them unduly. As important as this may be in the ordinary diversity litigation in a district court, it is even more important with respect to Chapter 13 proceedings for time is of the essence. The resources of the debtor are almost by definition limited and the means of determining eligibility must be efficient and inexpensive. To allow an extensive inquiry in each case would do much toward defeating the very object of the statute.

Pearson, 773 F.2d at 757. The Bankruptcy Appellate Panel of the Sixth Circuit expanded on this comparison in *In re Perkins*, 581 B.R. 822, 832 (B.A.P. 6th Cir. 2018) noting that, in the similar context of Chapter 12, eligibility is based on debts as of the petition date and not based on "computing eligibility after a hearing on the merits of the claims." *Id.* at 832. The court looked to whether "from the face of the schedules it is apparent to a legal certainty that the debtor is

beyond the debt limit" and also considered "if evidence shows that the amounts were inaccurately scheduled in bad faith for the purpose of making the debtor eligible for Chapter 13." *Id.* at 834; *cf. Scovis v. Henrichsen (In re Scovis)*, 249 F.3d 975, 982 (9th Cir. 2001) ("We now simply and explicitly state the rule for determining Chapter 13 eligibility under § 109(e) to be that eligibility should normally be determined by the debtor's originally filed schedules, checking only to see if the schedules were made in good faith.").

In making the determination, however, the court:

should neither place total reliance upon a debtor's characterization of a debt nor rely unquestionably on a creditor's proof of claim, for to do so would place eligibility in control of either the debtor or the creditor. *In re Madison*, 168 B.R. [986] at 989 [(D.Hawai'i 1994)]. At a hearing on eligibility, the court should thus, canvass and review the debtor's schedules and proofs of claim, as well as other evidence offered by a debtor or the creditor to decide only whether the good faith, facial amount of the debtor's liquidated and non-contingent debts exceed statutory limits.

*551 Barcal v. Laughlin (In re Barcal), 213 B.R. 1008, 1015 (B.A.P. 8th Cir. 1997). Further, a bankruptcy court can "scrutinize and redesignate the characterization by a debtor of any given debt when that characterization is the subject of a case or controversy." In re Stern, 266 B.R. 322, 326 (Bankr. D. Md. 2001); see also In re Kelly, No. 18-13244-WIL, 2018 WL 4354653, at *5 (Bankr. D. Md. Sept. 11, 2018) (Bankruptcy court can review a debt scheduled as "unknown" or "unliquidated" when it appears to a legal certainty to be owed in an amount other than what the debtor maintains.); In re De Jounghe, 334 B.R. 760, 768 (B.A.P. 1st Cir. 2005).

[2] Subchapter V presents a similar statutory urgency to resolve eligibility determinations as Chapters 12 and 13. Subchapter V was established to provide "an expedited process for small business debtors to reorganize quickly, inexpensively, and efficiently." *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333, 336 (Bankr. S.D. Fla. 2020); *see supra* H.R. Rep. No. 116-171. The debtor is required to file a plan within 90 days of the petition, unless extended if the court finds the "need for the extension is attributable to circumstances for which the debtor should not justly be held accountable." § 1189(b). A debtor must state in the petition whether it is a debtor as defined in § 1182(1) and whether it elects to proceed under Subchapter V. Federal Rule of Bankruptcy Procedure 1020(b) requires that the United States Trustee or a party in interest object to the debtor's election

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"no later than 30 days after the conclusion of the meeting of creditors held under § 341(a) of the Code, or within 30 days after any amendment to the statement whichever is later." Fed. R. Bankr. P. 1020.⁵

In contrast, there is no deadline for challenging the debtor's eligibility under Chapter 13.

The standards developed by the courts for Chapters 12 and 13 eligibility determinations provide useful guidance for § 1182. However, when Congress expanded the reach of Subchapter V to debtors who have up to \$7.5 million in debts, it made Subchapter V available to entities having more complex creditor relationships than a debtor in a typical Chapter 12 or 13 case. This case is an example. Few, if any, Chapter 13 debtors or Chapter 12 family farmers will have claims arising from their management of 42 operating facilities, or have received substantial PPP funds, or seek to reject numerous real estate leases in so-called first day motions. These more complex creditor relationships may well lead to bona fide disputes over the proper characterization of creditor claims.

- [3] The court need not find a lack of good faith or candor to conclude it should review the claims in this case. There is reasonable ground to dispute whether the lease rejection claims and the PPP funds were contingent and/or unliquidated as of the petition date—they present a valid "case or controversy." *In re Stern*, 266 B.R. at 326. Further, the debtor amended its schedules after the deadline expired for challenging its eligibility under Subchapter V and, indeed, after its eligibility was challenged. Therefore, the debtor's characterization of the claims is appropriate for court review.
- [4] In doing so, the court notes that § 1182 requires the consideration of debts "as of" the date of the filing of the petition, while the Chapter 13 eligibility determination looks to debts "on the date" of filing the petition. See § 109(e). The court finds no discernible difference in this language, considering how the phrase "as of" as used *552 in the Bankruptcy Code is interpreted by the courts. Most notably, § 541 includes as property of the estate all legal and equitable interest of the debtor "as of" the commencement of the case. The phrase "as of" places a temporal limitation on the reach of the bankruptcy estate. In re Chernushin, 911 F.3d 1265, 1269 (10th Cir. 2018), cert. denied sub nom. Cohen v. Chernushin, — U.S. —, 139 S. Ct. 2649, 204 L. Ed. 2d 284 (2019). It "establishes a clear-cut date after which property acquired by the debtor will normally not become property of the bankruptcy estate." Id.; see Am. Bankers Ins. Co. of Fla. v.

Maness, 101 F.3d 358, 362 (4th Cir. 1996) (other than limited statutory exceptions, property not owned at the time of the petition but only subsequently acquired by the debtor does not become property of the bankruptcy estate). "The normal rule of statutory construction" is that "identical words used in different parts of the same Act are intended to have the same meaning." Gustafson v. Alloyd Co., Inc., 513 U.S. 561, 562, 115 S. Ct. 1061, 131 L.Ed.2d 1 (1995).

The Lease Rejection Claims.

As set forth in the Findings of Fact, on May 21, 2020, the court authorized the rejection of five parking leases as of May 12, 2020, and without objection by the landlords, seven leases as of May 7, 2020, the petition date. ECF 75, 77. The debtor did not include the lease rejection claims on its schedules. The parties dispute whether the lease rejection claims were contingent as of the petition date.

- [7] Noncontingent debts are those where "all events necessary to give rise to liability take place prior to filing the petition." In re Green, 574 B.R. 570, 576-77 (Bankr. E.D.N.C. 2017) (cleaned up); see In re Aparicio, 589 B.R. 667, 674-75 (Bankr. E.D. Cal. 2018) (all events that triggered liability occurred prepetition). A debt is deemed contingent if liability relies on a future extrinsic event which may never occur. Id. at 577 (quoting In re Hanson, 275 B.R. 593, 596 (Bankr. D. Colo. 2002)) (quoting *In re Nesbit*, No. 99-28414JKF, 2000 WL 294834 at *2 (Bankr. W.D. Pa. March 16, 2000)). Contingent liabilities therefore are a class of liabilities in which the obligation to pay does not arise until the occurrence of a "triggering event or occurrence ... reasonably contemplated by the debtor and creditor at the time the event giving rise to the claim occurred." In re Barcal, 213 B.R. at 1013 (cleaned up).
- [8] Section 365(a) provides that a trustee or debtor in possession, "may assume or reject any ... unexpired lease of the debtor." § 365(a). "The authority to reject an executory contract [or unexpired lease] is vital to the basic purpose of a Chapter 11 reorganization, because rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization." *In re Shangra-La, Inc.*, 167 F.3d 843, 849 (4th Cir. 1999) (quoting *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528, 104 S. Ct. 1188, 79 L.Ed.2d 482 (1984)). Similarly, the power to assume and/or assign an unexpired lease "gives the trustee significant flexibility in managing the estate." *In re Shangra-La, Inc.*, 167 F.3d at 849.

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[9] Section 365(a) expressly makes the assumption or rejection of an executory contract or unexpired lease "subject to the court's approval." § 365(a). A motion to assume, reject, or assign an executory contract or unexpired lease is governed by Fed. R. of Bankr. P. 9014. Fed. R. Bankr. P. 6006(a). Notice must be given to the nondebtor party to the contract or lease, the United States Trustee, and any other parties in interest as the court may direct. *Id.* 6006(c). A debtor's decision to reject an executory contract or unexpired lease "is to be accorded the deference mandated by *553 the sound business judgment rule as generally applied by courts to discretionary actions or decisions of corporate directors." *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1046–47 (4th Cir. 1985).

[10] [11] Because the rejection of an executory contract or unexpired lease requires court approval, rejection is not a unilateral, independent process that can be accomplished by the debtor alone:

[A] debtor may not agree to assume or reject an executory contract until after the bankruptcy case is commenced and the debtor is acting in the capacity of debtor-in-possession. Even then, the Bankruptcy Code prevents the debtor-in-possession from making a unilateral decision to assume or reject a contract. Section 365(a) requires court approval of the decision and § 1109 states that a "party in interest, including ... a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on *any issue* in a case under [chapter 11]." 11 U.S.C. § 1109 (emphasis added).

In re Trans World Airlines, Inc., 261 B.R. 103, 115 (Bankr. D. Del. 2001). The requirement for court approval is particularly important in the rejection of unexpired commercial leases. As the Fourth Circuit has recognized, a "leasehold interest often proves to be the most valuable asset in a small business bankruptcy." *In re Shangra-La, Inc.*, 167 F.3d at 849.

[12] The rejection or assumption of an executory contract or unexpired lease does not determine whether the nondebtor party holds a claim; it establishes the nature of the claim as either "a pre-petition obligation of the debtor or as an administrative expense entitled to the highest priority." *In re Stewart Foods, Inc.*, 64 F.3d 141, 144 (4th Cir. 1995) (citing *Leasing Serv. Corp. v. First Tenn. Bank Nat'l Assoc.*, 826 F.2d 434, 437 (6th Cir. 1987)).

The rejection of an executory contract constitutes a breach of the contract, and a party's damages resulting from that rejection are treated as a pre-petition claim and receive the priority provided to general unsecured creditors. Where the debtor-in-possession assumes an executory contract, the expenses and liabilities incurred may be treated as administrative expenses and receive the highest priority on the debtor's estate.

Id.; see § 365(g). Until an executory contract is assumed or rejected, the debtor's obligations under the contract are an administrative expense claim of the estate. See e.g., § 365(d) (5).

[13] Here, the rejection of leases was not approved until May 21, 2020; any resulting lease rejection claims thus were contingent obligations until that time. Five of the leases were rejected as of May 12, 2020. The debtor's request to reject these leases was pending, and any lease rejection claims were contingent, until the court resolved the debtor's rejection motion. The prerequisites to the debtor's rejection of the leases, and any resulting lease rejection claims, were necessarily post-petition events. Consequently, the lease rejection claims were contingent as of the petition date and remained so until the issuance of the Court's order approving the rejections. "[A]ll events necessary to give rise" to the lease rejection claims did not occur as of the petition date. *In re Green*, 574 B.R. at 576.

[14] Seven of the leases were rejected "as of" the petition date. The rejection of these leases was also approved by the court on May 21, 2020. Superficially, at least, the deemed effective date of the rejection—"as of" the petition date—appears to match § 1182's statutory requirement *554 to consider debts as they exist "as of" the date of filing. But this question gives the court pause.

Resolution of this question requires the court to delve into the extent to which courts take into account post-petition events when making an eligibility determination, at least in Chapters 12 and 13. Many post-petition actions could result in contingent claims becoming noncontingent after the case is filed. As one court succinctly stated:

Numerous events may occur postpetition to affect a debtor's total secured or unsecured debt. Collateral may be liquidated, converting a secured claim to an unsecured deficiency claim. Contingent personal guaranties may be liquidated after the creditor pursues a co-debtor, surety, or principal. A creditor may file a postpetition claim treated under the Code as prepetition, such as a lease rejection claim under § 365(g) or a § 1305 claim. Or, as was the case

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here, a judgment might be modified or vacated by the trial court that issued the judgment or later on appeal.

The majority of courts that have considered the effect of a postpetition event on eligibility to file (or be converted) to Chapter 13 have concluded that postpetition events should not be considered in determining eligibility. To hold otherwise would mean that a debtor could float in and out of Chapter 13 eligibility during the course of a case, depending on what happens, which of course makes no legal or practical sense.

The ... plain language of § 109(e) requires consideration of the debts as they exist as of the petition date, irrespective of postpetition events. *E.g., In re Wiencko*, 275 B.R. 772 (Bankr. W.D. Va. 2002); *In re Slack*, 187 F.3d 1070 (9th Cir. 1999); *In re Snell*, 227 B.R. 127 (Bankr. S.D. Ohio 1998); *In re Harwood*, 519 B.R. 535, 539–40 (Bankr. N.D. Cal. 2014); *In re Pearson*, 773 F.2d 751, 758 (6th Cir. 1985) ("[T]he fact that some later resolution of the conflict might render more certain the precise nature of the debt itself ... is relatively immaterial in determining the debtors' financial condition and Chapter 13 eligibility on the date the petition is filed.... We do not believe that the statute requires any more" than a realistic look at "the state of the debtors' affairs" on the petition date).

In re West, No. 16-40358-CAN7, 2017 WL 746250, at *16 (Bankr. W.D. Mo. Feb. 24, 2017).

The court agrees with the foregoing analysis, even for the leases rejected "as of" the petition date. As with the leases rejected as of May 12, 2020, the prerequisites to the debtor's rejection of the leases, and any resulting lease rejection claims, were necessarily post-petition events. The lease rejection claims were contingent on the petition date and for two weeks following that date, and could only become noncontingent when the court approved the rejection. "All of the events necessary to give rise" to the lease rejection claims did not occur until two weeks after the petition date.

Not only does this approach meet the statutory directive to determine debt limits as they exist as of the date of filing, but it has the very real benefit of providing certainty to the process. As stated above, Subchapter V is designed to provide "an expedited process for small business debtors to reorganize quickly, inexpensively, and efficiently." *In re Seven Stars on the Hudson Corp.*, 618 B.R. at 336. Opening up eligibility determinations to post-petition events, even if deemed to apply retroactively, is contrary to the purpose and spirit of

Subchapter V, and could nullify the very benefits it is intended to convey.

*555 Finally, the objecting parties point to § 365(g), which makes the rejection of an unexpired lease that has not been assumed a "breach of such contract or lease ... immediately before the date of the filing of the petition." § 365(g). They argue that § 365(g) establishes that the rejection claims are prepetition debts, and therefore must be included in the debt limit determination upon rejection. The argument is unavailing. The question is not whether lease rejection claims are treated as prepetition debts once the leases are rejected—that point is not disputable—but whether the lease rejection claims were noncontingent debts as of the date of filing. The claims were contingent until the court approved the lease rejections.

The court therefore concludes that the lease rejection claims were contingent as of the date of filing and are not considered in the debt limitation determination.

The PPP Funds.

[15] Prior to the petition, the debtor received \$1,862,723.84 of PPP funds from Truist Bank. ECF 198. On May 13, 2020, the court entered an order requiring the debtor "to abide by the certifications the debtor has made as to the limited use of PPP funds in a manner and for purposes permitted by the CARES Act and other laws governing the use of such funds." ECF 37. In connection with the dispute over the debtor's eligibility, it submitted a declaration by its Director of Human Resources stating that, since the bankruptcy filing, the debtor has used all of the loan proceeds in accordance with the PPP requirements and intends to seek forgiveness of the entire balance in accordance with the PPP requirements. ECF 198.

The debtor contends any obligation to repay the PPP funds was both contingent and unliquidated as of the date of filing. It argues the PPP funds are a government grant and it only must repay them if it does not comply with PPP requirements. JBGS contends the obligation to repay the PPP funds is evidenced by a promissory note in a fixed amount, and therefore the funds were a noncontingent liquidated debt as of that date. Notably, neither the UST, nor Truist Bank, which advanced the PPP funds, joins JBGS's contention that the PPP funds should be included in the debt limit determination as a noncontingent liquidated debt. The court concludes that the debtor's obligation to repay the PPP funds was contingent and unliquidated as of the date of filing, and the PPP debt is therefore excluded from the eligibility determination.

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The PPP was created by the CARES Act and intended to provide emergency economic assistance to help individuals and businesses cope with the economic and public health crises triggered by the worldwide COVID-19 pandemic. *See* SBA, Interim Final Rule, 85 Fed. Reg. 20,811 (April 15, 2020) (the "First Interim Final Rule"). "The intent of the CARES Act is that SBA provide relief to America's small businesses expeditiously" with a "focus on keeping workers paid and employed." *Id.*

Section 1102 of the CARES Act, codified at 15 U.S.C. § 636(a)(36), temporarily permits the SBA to guarantee loans under a new program titled the "Paycheck Protection Program." Section 1106 of the CARES Act, codified at 15 U.S.C. § 9005, provides for forgiveness of up to the full principal amount of qualifying loans guaranteed under the PPP. See id.

The PPP is a unique government financial accommodation created to provide businesses with necessary financial relief to withstand the devastating economic effects of the COVID-19 pandemic. Due to its unique nature, courts have not agreed on the proper characterization of the nature of the PPP. The issue has arisen most often in bankruptcy proceeding when debtors *556 contend the Administrator of the United States Small Business Administration ("SBA") violated the anti-discrimination provisions of § 525(a) by excluding debtors in bankruptcy from participating in the PPP.

In *iThrive Health, LLC v. Carranza*, this court addressed the issue. For purposes of § 525, this court characterized the PPP as a loan accompanied by a government guaranty that will result in forgiveness of the loan. *iThrive Health, LLC v. Carranza*, No. 20-00151, ECF 24 at 8 (Bankr. D. Md. June 8, 2020). It applied the rationale of the Fourth Circuit in *Ayes v. U.S. Dep't of Veterans Affairs*, 473 F.3d 104 (4th Cir. 2006), and concluded that, although the PPP is akin to a grant, the PPP did not meet the specific standards in *Ayes* to be a "license, permit, charter, franchise or other similar grant" so as to fall within the ambit of § 525(a). *Id*.

In so holding, however, the court recognized that:

The central characteristic of the PPP is that the recipient fully anticipates the SBA will satisfy its guaranty by paying the loan to the issuing financial institution PPP funds, in essence, are a distribution of government funds to be used by businesses to survive the devastating economic consequences of the COVID-19 pandemic. They

are intended to enable businesses to pay employees and certain other critical expenses that they likely would not otherwise be able to pay.

Id. (emphasis added).

Here, the court is being called upon to address a different question: whether the PPP is a noncontingent and liquidated debt as of the petition date. It might seem apparent that a financial accommodation intended to provide "a distribution of government funds to be used by businesses to survive the devastating economic consequences of the COVID-19 pandemic" would be a contingent and unliquidated debt, but that is the question the court must resolve. The parties have not cited to any case that has addressed this question.

In considering whether the PPP is contingent, the court considers whether "all of the events necessary to give rise to liability [took] place prior to filing the petition," or whether "liability relies on some future extrinsic event which may never occur." *In re Green*, 574 B.R. at 577-580. The obligation to pay a contingent liability does not arise until the occurrence of a "triggering event or occurrence ... reasonably contemplated by the debtor and creditor at the time the event giving rise to the claim occurred." *In re Barcal*, 213 B.R. at 1013.

To resolve the dispute, the court must determine the nature of the PPP debt and the debtor's obligation to repay it. Under the PPP, an applicant submits a PPP Borrower Application Form to a SBA approved lending institution. The loan forgiveness is recognized and acknowledged in the application. As the application existed when the debtor applied, it provided:

I understand that loan forgiveness will be provided for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities, and not more than 25% of the forgiven amount may be for non-payroll costs. (SBA Form 2483 (04/20)).⁶

This form has been amended on at least two occasions, the provisions referenced herein are also found in the most recent borrower application form, SBA Form 2483, revised June 24, 2020.

The lending institution reviews the application and decides whether it meets the SBA requirements for funding. Significantly, "lenders are subject to relatively few *557 underwriting obligations before issuing loans ... neither lenders nor SBA are conducting typical analysis of the characteristics of PPP applicants" SBA, Interim Final

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Rule, 85 Fed. Reg. 38,303 (June 26, 2020). Further, the CARES Act waives regular SBA fees, suspends the requirement that small businesses be unable to obtain credit elsewhere and waives any requirement for a personal guarantee or collateral for the covered loans. *See* 15 U.S.C. § 636(a)(36)(H), (I) and (J).

Upon approval, the applicant executes a PPP form of promissory note and funds are disbursed. The note itself expressly incorporates the PPP requirements and provides for the forgiveness. Here, the debtor executed, in favor of Truist Bank, a Paycheck Protection Program Promissory Note (the "PPP Note"). In the PPP Note, the debtor represents and warrants that "the loan evidenced by this Note is being made solely for the permitted use of proceeds specified by the CARES Act and related regulations, rules and guidance." Proof of Claim 1-1, Part 2, p. 3. The PPP Note further provides:

Borrower acknowledges that (a) loan forgiveness will be provided by the SBA for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities, and not more than 25% of the Forgivable Amount may be for on-payroll costs and (b) the forgiveness amount is subject to reduction based on employee headcount and compensation reductions during the 8-week loan period as compared to the prior periods in accordance with the CARES Act.

Id. at p. 2 (emphasis added). In the PPP Note:

Borrower acknowledges and agrees that all proceeds of the Loan shall be used solely to fund the uses specified in the Paycheck Protection Program Rule ("Allowable Costs"); provided that, for the avoidance of doubt, in no event shall more than twenty-five percent (25%) of the total Allowable Costs paid by Borrower using proceeds of the Loan be attributable to non-payroll costs.

At the conclusion of the Forgiveness Period, Borrower shall promptly but in no event more than thirty (30) days following the conclusion of the Forgiveness Period submit to Bank all documentation, accompanying certifications and other relevant disclosures required by the SBA under the CARES Act or otherwise requested by Bank on the worksheet provided by Bank for calculation of loan forgiveness amounts, a copy of which will be provided to Borrower after the date hereof.

Id. at p. 3. The PPP Note contains numerous provisions tying the obligation to the PPP rules and regulations. As examples:

Borrower has read the statements included in the application related to this loan (the "Application") including the Statements Required by Law and Executive Orders, and Borrower understands them.

Borrower was and remains eligible to receive a loan under the rules in effect at the time the Application was submitted that have been issued by the Small Business Administration ("SBA") implementing the Paycheck Protection Program under Division A, Title I of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") (the "Paycheck Protection Program Rule").

All proceeds of the Loan will be used only for businessrelated purposes as specified in the Application and consistent with the Paycheck Protection Program Rule.

The current economic uncertainty makes the request for the Loan necessary to *558 support the ongoing operations of Borrower.

All proceeds of the Loan will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments, as specified under the Paycheck Protection Program Rule and Borrower acknowledges that if the funds are knowingly used for unauthorized purposes, the federal government may hold Borrower and/or Borrower's authorized representative legally liable, such as for charges of fraud.

Borrower has reviewed the SBA's affiliation rules and standards, including the application of such affiliation standards to eligibility requirements for the Paycheck Protection Program, and, after due and careful consideration, represents and warrants that Borrower satisfies all requirements for eligibility for the Paycheck Protection Program.

Borrower acknowledges that it has calculated the eligible Loan amount using the supporting documents which it has submitted to Bank. Borrower further acknowledges that execution of this Note constitutes Borrower's certification that it is in agreement with the Principal Amount of the Loan as set forth herein and that such Principal Amount is not in excess of the maximum principal amount permitted accordance with the CARES Act.

Id. at p. 1-2.

The nature of the debtor's obligation to repay the PPP loan must be determined by reference to the PPP Note, as

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amplified by the CARES Act itself, the SBA Rules, and the PPP application. Section 1106 of the CARES Act provides for forgiveness of up to the full principal amount of PPP qualifying loans. This is the essential purpose of the PPP. The SBA confirms this essential purpose in unequivocal terms:

SBA will forgive loans if all employee retention criteria are met, and the funds are used for eligible expenses.

U.S. Small Business Administration, Paycheck Protection Program, https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program (last visited Aug. 13, 2020).

The PPP application establishes at the very inception of the borrower's involvement the nature of the financial accommodation which the applicant seeks: a loan for which "forgiveness will be provided for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities, and not more than 25% of the forgiven amount may be for non-payroll costs." SBA Form 2483 (04/20) (emphasis added). In applying for PPP funds, the applicant need not provide much, if any, financial information, or offer any collateral or guaranty.

The PPP Note incorporates the SBA rules governing the PPP and obligates the borrower to use the funds in accordance with the PPP. More significantly, it also expressly provides that "loan forgiveness *will be provided* by the SBA for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities" Proof of Claim 1-1, Part 2 at p.2 (emphasis added).

The foregoing establishes that forgiveness is the essential characteristic of the debtor's obligation under the PPP Note and the PPP requirements. But for forgiveness, there is no PPP. Accordingly, as of the petition date, the debtor's liability to repay the PPP is dependent on it using the funds for ineligible expenses or failing to meet employee retention criteria. The debtor's liability to repay the PPP "relies on some future extrinsic event which may never occur." *In re Green*, 574 B.R. at 577. Additionally, it is subject to a "triggering event or occurrence ... reasonably contemplated *559 by the debtor and creditor at the time" the debtor applied for and obtained the PPP funds. *In re Barcal*, 213 B.R. at 1013. Therefore, the debtor's obligation was contingent as of the date of filing.

[16] [17] The court also concludes that the debtor's obligation under the PPP was unliquidated as of the petition date. The Bankruptcy Code does not define the term

"liquidated." Again, borrowing from Chapter 13 cases, the concept of a liquidated debt relates to the amount of liability, not the existence of liability. United States v. Verdunn, 89 F.3d 799 (11th Cir. 1996). Courts generally hold that "the key factor in distinguishing liquidated from unliquidated claims is not the extent of the dispute nor the amount of evidence required to establish the claim, but whether the process for determining the claim is fixed, certain, or otherwise determined by a specific standard." In re Barcal, 213 B.R. at 1014. See In re Adams, 373 B.R. 116, 119-120 (B.A.P. 10th Cir. 2007) (a "debt is readily determinable only if the process of determining the claim is fixed, certain, or otherwise determinable by a specific standard"). See In re Slack, 187 F.3d at 1073 ("debt is liquidated for the purposes of calculating eligibility for relief under § 109(e) if the amount of the debt is readily determinable."); In re Stern, 266 B.R. 322 (quoting and adopting *In re Barcal*, 213 B.R. at 1014, to determine that debts were fixed amounts due pursuant to a contract).

As explained above, the debtor will have no obligation to repay the PPP funds if all employee retention criteria are met, and the funds are used for eligible expenses. As of the petition date, the debtor had certified it intended to meet the employee retention criteria and use the funds for eligible expenses. Further, early in the case, the court entered an order requiring the debtor to do so. ECF 37. In connection with this dispute, the debtor submitted a declaration stating that, in fact, it has used all of the loan proceeds in accordance with the PPP requirements and will seek forgiveness of the entire loan balance in accordance with the PPP requirements. ECF 198.

The PPP obligation was not liquidated as of the petition date because it was not then known, and could not be determined, whether the debtor would use the PPP funds for ineligible expenses or would fail to maintain employee staffing levels in accordance with the PPP. Thus, it could not be determined what amount, if any, of the PPP funds the debtor would be obligated to repay.

Further, the loss of forgiveness is not an all or nothing proposition. Where a borrower fails to meet the SBA rules and CARES Act regulations, the borrower may still be granted forgiveness for the portion of the loan used in compliance with the rules and regulations. The extent to which a borrower will be obligated to repay the PPP loan depends on the amount of PPP funds it uses for ineligible purposes and the extent of its failure to maintain staffing levels. In these events, the amount of the loan forgiveness is based on amounts spent by borrower

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on payroll costs including taxes, insurance, salary, wages, and tips; ⁷ owner compensation replacement; and non-payroll costs including interest payments on business mortgage of real or *560 personal property; payment on business rent obligations of real or personal property; business utility payments for electric, gas, water, transportation, telephone or internet.⁸

7 For example, payroll costs are computed as follows (with additional exceptions not substantively relevant hereto): Under 1106(d)(5) of the CARES Act, at least 75% of the loan forgiveness amount must be for payroll costs. This amount was reduced to 60% in section 3(b) of the Flexibility Act. 15 U.S.C. § 9005(d)(8). Payroll costs include salary, wages, commissions or similar compensation, including salary, wages or commissions to furloughed employees. 15 U.S.C. § 9005(a)(8). For loans disbursed before June 5, 2020 and for borrowers electing to use an 8-week "covered period" (a defined term in the CARES Act) covered payroll costs for owneremployees and self-employed individuals is capped at 8 weeks' worth of 2019 compensation or \$15,385 per individual, whichever is less. For loans eligible for or electing a 24-week "covered period," covered payroll costs are capped at 2.5 months' worth of 2019 compensation or \$20,833 per individual, whichever is less. SBA, Interim Final Rule 85 Fed. Reg. 38,304 (June 26, 2020).

If borrower reduces its full-time equivalent employees during the "covered period," loan forgiveness is reduced by the same percentage as the percentage reduction in full-time equivalent employees. 15 U.S.C. § 9005(d)(2). The term full-time equivalent employee is not defined in the CARES Act, the Administrator has defined the term as any employee who works 40 hours or more, on average, each week. A borrower's loan forgiveness will also be reduced if borrower has reduced an employee's salary or wages in excess of 25%. 15 U.S.C. § 9005(d) (3). In general, forgiveness is reduced by the total dollar amount of the salary or wages reductions that are in excess of 25% of base salary or wages, subject to exceptions for borrowers who restore reduced wages or salaries.

The complexity of the PPP lies within the many interim rules adopted to implement the CARES Act, addressing the employee retention criteria, eligible costs and expenses, and other matters that can result in the recipient's obligation to repay the loan if all employee retention criteria are not met, and the funds are not used for eligible expenses. The SBA has published, as of the date of this opinion, at least twenty-four interim final rules, covering everything from affiliation, eligibility, promissory notes, seasonal employers, lender requirements, loan increases, cooperatives, loan forgiveness and lender/borrower responsibilities-just to name a few. All interim final rules are published in the Federal Register and are most easily accessed on the U.S. Department of Treasury website: https://home.treasury.gov/policyissues/cares/assistance-for-small-businesses.

Again, as of the petition date, it could not be determined the extent to which the debtor might use the PPP funds for ineligible expenses or might fail to maintain employee staffing levels. It turns out the debtor complied with these requirements and anticipates complete forgiveness. *See* ECF 198. But considering the question as of the petition date, there was no way to determine what amount, if any, the debtor might be obligated to repay. Therefore, the debtor's obligation under the PPP was unliquidated as of the date of the filing, and is excluded from the debt limitation determination under § 1182.

Conclusion

For the foregoing reasons, the court concludes the lease rejection claims and PPP obligation were contingent as of the date of filing, and the debtor's obligation to repay the PPP was unliquidated as of that date. Therefore, these claims are not included in the debt limitation determination of § 1182 and the debtor is eligible to proceed under Subchapter V.

All Citations

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End of Document

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In re Macedon Consulting, Inc., 652 B.R. 480 (2023)

KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Zhang Medical P.C., Bankr.S.D.N.Y., November 30, 2023

652 B.R. 480

United States Bankruptcy Court, E.D. Virginia, Alexandria Division.

IN RE: MACEDON CONSULTING, INC., Debtor.

Case No. 23-10300-KHK | Signed June 14, 2023

Synopsis

Background: Lessors filed motion to dismiss corporate debtor's bankruptcy case under Subchapter V of Chapter 11. Debtor objected, and filed motion to reject unexpired leases of commercial office space and executory contracts related thereto.

Holdings: The Bankruptcy Court, Klinette H. Kindred, J., held that:

- [1] Bankruptcy Court would not use its equitable powers under statute allowing court to enter "necessary or appropriate" orders to dismiss debtor's bankruptcy case;
- [2] liability of \$14,390,820 under leases was noncontingent and liquidated, for purposes of assessing debtor's eligibility for relief under Subchapter V;
- [3] Bankruptcy Court would revoke Subchapter V designation, rather than dismiss the case;
- [4] lessors failed to show that debtor's Chapter 11 case was objectively futile;
- [5] lessors failed to show that debtor filed its Chapter 11 case in subjective bad faith; and
- [6] debtor's decision to reject leases was a reasonable exercise of debtor's business judgment.

Motion to dismiss denied; motion to reject leases granted.

West Headnotes (9)

[1] **Bankruptcy** \leftarrow Carrying out provisions of Code

Bankruptcy ightharpoonup In General; Grounds in General

Bankruptcy Court would not use its equitable powers under statute allowing court to enter "necessary or appropriate" orders to dismiss debtor's bankruptcy case under Subchapter V of Chapter 11, because a more specific provision of the Bankruptcy Code governed "cause" for conversion or dismissal of Chapter 11 cases, including in Subchapter V cases. 11 U.S.C.A. §§ 105, 1112, 1181.

- 1 Case that cites this headnote
- [2] Statutes General and specific terms and provisions; ejusdem generis

Statutes General and specific statutes

It is a commonplace of statutory construction that the specific governs the general.

[3] Bankruptcy 🕪 "Bad faith."

Bankruptcy Realistic possibility of reorganization

Without subjective bad faith and objective futility, dismissal of Chapter 11 case is not proper. 11 U.S.C.A. § 1112(b).

[4] Bankruptcy ← Reorganization cases

Bankruptcy ← Contingent or Unliquidated
Claims

In considering whether debt is "contingent," and is thus not considered when assessing a Chapter 11 debtor's eligibility for relief under Subchapter V as small business debtor, court considers whether all of the events necessary to give rise to liability took place prior to filing the petition, or whether liability relies on some future extrinsic event which may never occur. 11 U.S.C.A. § 1182(1)(A).

In re Macedon Consulting, Inc., 652 B.R. 480 (2023)

2 Cases that cite this headnote

[5] Bankruptcy ← Reorganization cases Bankruptcy ← Contingent or Unliquidated Claims

Liability of \$14,390,820 under corporate debtor's leases of commercial office space was noncontingent and liquidated, for purposes of assessing debtor's eligibility for relief under Subchapter V of Chapter 11 as small business debtor; liability arose prepetition, on dates the leases were fully executed, and timing of payments was not based on a future extrinsic event that might never occur. 11 U.S.C.A. § 1182(1)(A).

1 Case that cites this headnote

[6] Bankruptcy ← Reorganization cases Bankruptcy ← In General; Grounds in General

Where corporate debtor was ineligible for relief under Subchapter V of Chapter 11 as small business debtor because debtor's noncontingent liquidated liabilities exceeded \$7.5 million Subchapter V debt limit, Bankruptcy Court would revoke the Subchapter V designation, rather than dismiss the case, because the only parties who would be better off from a dismissal of the case would be lessors. 11 U.S.C.A. § 1182(1)(A).

2 Cases that cite this headnote

[7] **Bankruptcy** Realistic possibility of reorganization

Lessors failed to show that corporate debtor's Chapter 11 case was objectively futile, as required to warrant dismissal, where debtor had already proposed a 100% repayment to creditors when accounting for rejection of leases of commercial office space, regardless that there may be some tweaks to that plan hereafter. 11 U.S.C.A. § 1112(b).

[8] Bankruptcy 🕪 "Bad faith."

Lessors failed to show that corporate debtor filed its Chapter 11 case in subjective bad faith, as required to warrant dismissal; instead, there was a landscape of economic uncertainty and debtor was seeking to limit its liabilities and pay its creditors what they were entitled to under the Bankruptcy Code so that it could service its debt, pay and retain its employees, pay trade creditors and turn a profit. 11 U.S.C.A. § 1112(b).

[9] Bankruptcy 🕪 Leases

Chapter 11 debtor's decision to reject leases of commercial office space was a reasonable exercise of debtor's business judgment, and therefore would be allowed, after debtor saw an approximate 40 percent downturn in monthly revenue, experienced a loss in client work, and entire workforce worked remotely and was reduced as a result of COVID-19 pandemic. 11 U.S.C.A. § 365(a).

Attorneys and Law Firms

*481 Michael T. Freeman, Sara Kathryn Mayson, Office of the US Trustee, Alexandria, VA, for U.S. Trustee.

Michael E. Hastings, Woods Rogers Vandeventer Black PLC, Roanoke, VA, for Debtor.

MEMORANDUM OPINION

Klinette H. Kindred, United States Bankruptcy Judge

This matter was before the Court on May 15, 2023 for a hearing on (a) the Motion to Dismiss¹ this case filed by Plaza Office Realty I, LLC ("Plaza Office") and Teachers Insurance and Annuity Association of America ("Teachers" and collectively referred to as the "Lessors") and the Objection² thereto filed by Macedon Consulting Inc. (the "Debtor," the "Company" or "Macedon") and (b) the Debtor's Motion to (I) Reject Certain Unexpired Leases of Real Property and Executory Contracts Related Thereto Effective

as of the Rejection Date and (II) Abandon Any Personal Property Located at Locations Covered By Such Unexpired Leases, ³ and the Objection thereto. ⁴

- Docket No. 72.
- 2 Docket No. 121.
- Docket No. 11.
- Docket No. 77.

Counsel for the Lessors and for the Debtor appeared and presented argument and evidence in support of their positions. At the close of the Lessors' presentation, the Debtor moved for a directed verdict, which the Court deferred ruling on until the conclusion of the evidentiary hearing. At the conclusion of the hearing, the Court ruled from the bench, denying the Lessors' Motion to Dismiss and granting the Debtor's Motion to Reject. The Court now memorializes that ruling in this Memorandum Opinion.

*482 Findings of Fact

Macedon is a corporation organized under the laws of the Commonwealth of Virginia.⁵ The company was formed in 2009 and is an information technology solutions provider.⁶ Macedon's revenue is mostly derived from building custom workflow solutions for commercial and federal government clients. Between 2009 and the onset of the COVID-19 pandemic, Macedon experienced steady growth in its revenue and workforce, ultimately employing approximately 130 people and generating revenue of \$22 million in calendar year 2019.8 In October 2013, Macedon entered into a lease with Plaza Office for commercial office space.9 Then in January 2020, Macedon entered into a lease with Teachers for additional commercial office space. ¹⁰ The total uncapped amount owed under the Plaza Office Lease is approximately \$9,637,501.¹¹ The total uncapped amount owed under the Teachers' Lease is \$4,753,319. 12 Combined, the uncapped Lease obligations total \$14,390,820. The Debtor has scheduled what would ultimately be the lease rejection claim amounts as capped under section 502(b)(6) of the Bankruptcy Code. 13

5 See Docket No. 10, page 2.

- 6 *Id.*
- 7 *Id*.
- 8 *Id* at 2-3; Docket No. 133 (the "Transcript"), 103:9-13; 143:15-23.
- Docket No. 122-1, Exhibit 1A (the "Plaza Office Lease").
- Docket No. 122-5, Exhibit 2A (the "Teachers' Lease" and together with the Plaza Office Lease, the "Leases"); Transcript 143-144.
- Docket No. 124-33, pg. 65, Exhibit AG ("Davis Expert Report"), Exhibit 4.1.
- Davis Expert Report, pg. 67, Exhibit 4.2.
- Docket No. 1, pgs. 25-26, Schedule E/F.

In the second quarter of 2020, as a result of the pandemic, Macedon saw an approximate forty percent downturn in monthly revenue and also experienced a loss in client work. 14 Prior to the pandemic, approximately fifteen percent of Macedon's workforce worked remotely. 15 At present, in part as a result of the pandemic, Macedon's entire workforce works remotely and has been reduced from 130 employees to approximately 74 employees. 16 As a result of the company's downturn in revenue, reduction in workforce and the shift to remote working, Macedon determined that it no longer needed the Leases and the corresponding office space. 17

- 14 Transcript 224:16-18; 227:1-7.
- Transcript 106:5-7.
- Transcript 106:8-10; 231:19-21.
- 17 Transcript 104:20-25; 105:1-4.

Thereafter and throughout what was approximately a three-year period leading up to the petition date, Macedon attempted to find subtenants and/or assignees for the Leases and other attending Lease obligations but was ultimately unsuccessful in doing so. ¹⁸ At one point Macedon was close to securing an assignment of one of the Leases, but because it was not willing to provide a letter of credit in connection with the transaction, the affected Lessor was not willing to provide a necessary consent to the assignment. ¹⁹ From the record before the Court, it appears Macedon engaged in good faith negotiations with its counterparties and that those counterparties likewise engaged in good faith negotiations,

*483 notwithstanding the failure to agree to terms at the conclusion of those negotiations. Following the failed negotiations, Macedon requested termination of the Leases and offered the Lessors what amounted to three months of rent plus the rejection damages that would be owed under section 502(b)(6) of the Bankruptcy Code.²⁰

- 18 Transcript 153:10-19.
- 19 Transcript 164:1-15.
- Transcript 55:18-20; Docket No. 122-10, pg. 2, Exhibit 6.

Between 2021 and 2022, Austin Rosenfeld, the principal of the Debtor, received approximately \$5.35 million in distributions from the Debtor of which \$1.58 million was owed to pay income taxes, and the remaining \$3.67 million represented profit distributions. 21 Mr. Rosenfeld testified that he mostly takes distributions when he has a tax payment that is due and that he otherwise takes distributions of profit from the Company when he identifies an investment opportunity and for his salary.²² Mr. Rosenfeld testified that Macedon is an "S corporation," so he reports all profits from the Debtor on his personal income tax returns whether or not he takes any profits out of the company in a given tax year. 23 Mr. Rosenfeld also testified that aside from tax obligations that were paid, the other "three million or so," he generally left in Macedon as retained earnings.²⁴ He further testified that although Macedon had planned to use the retained earnings to expand the business by acquiring a competitor, it was never able to find a suitable business to purchase.²⁵

- Transcript 52:3-6; 119:6-9; Davis Expert Report, pg. 13, n 11. The approximate \$105,000 discrepancy between the Davis Expert Report numbers and the \$5.35 million Mr. Rosenfeld testified to is reconciled by reference to an additional \$105,000 payment made for taxes. *See* Transcript 120:6-15.
- 22 Transcript 133:16-24; 134:1-13.
- 23 Transcript 134:14-23.
- 24 Transcript 135:17-20.
- 25 Transcript 135:21-25.

Sometime around October 2021 when Macedon determined that it would not be able to make a suitable acquisition, Mr. Rosenfeld took a distribution from the retained earnings. ²⁶ Mr. Davis, the financial expert in this case, testified that

Mr. Rosenfeld's practice of taking distributions to pay tax obligations was common practice for principals of LLCs and S corporations. Further, the Davis Expert Report opines that even if Macedon had retained the profit distributions, its reserves would still be insufficient to honor the remaining terms of the Leases and the additional cash would only delay the anticipated liquidity crisis. ²⁷ Mr. Davis testified that if the Leases are not rejected, the Debtor will encounter a cash deficiency in February 2026. ²⁸ He also testified that failing to reject the Leases now will accelerate the Debtor's cash deficiency going forward which will increase the risk that the Debtor will not be able to absorb future unfavorable variants in the market, and thereby increase risk to the Debtor's employees and customers and the business itself. ²⁹

- 26 Transcript 136:19-24.
- 27 Transcript 316:13-17; Davis Expert Report, pg. 13, n 11.
- Transcript 236:16-21; 237:3-9. Mr. Davis testified that this cash deficit assumes a minimum \$1 million cash balance to fund continuing operations and "absorb fluctuations in receivables and payables and collections," and that he arrived at such a minimum balance by analyzing companies that are comparable to Macedon. Mr. Davis testified that he determined that on a weighted average basis, such similar companies operated off of approximately \$1.4 million in working capital.
- 29 Transcript 291:3-20.

*484 On February 28, 2023, Macedon filed a voluntary petition for relief under subchapter V of chapter 11 of the Bankruptcy Code.³⁰ That same day, the Debtor also filed its Motion to Reject the Leases³¹ and its Plan of Reorganization³² in which it proposed to pay one hundred percent of allowed claims (assuming the rejection of the Leases was approved). Thereafter, the Lessors filed their Motion to Dismiss arguing that the case should be dismissed 1) under section 105 of the Bankruptcy Code as an abusive filing; 2) for cause under section 1112(b) of the Code; and 3) for lack of eligibility under subchapter V.³³ The Lessors have also, in essence, asked this Court to either disregard the two-prong test for dismissal established by the Fourth Circuit's decision in Carolin Corp. v. Miller, 886 F.2d 693 (4th Cir. 1989), and alternatively, has asked the Court to create a carve-out from that two-prong test in a circumstance where the debtor is not in financial distress.³⁴ In response to the Motion to Reject, the Lessors merely reiterated their arguments presented in their Motion to Dismiss. Both parties

indicated at the evidentiary hearing that they would rest on their papers with respect to the Motion to Reject. 35

- 30 Docket No. 1.
- 31 Docket No. 11.
- 32 Docket No. 13.
- 33 Docket No. 72.
- 34 Docket No. 72, pg. 18.
- 35 Transcript 346:4-9, 13.

Conclusions of Law

The Court has jurisdiction over this matter under 28 U.S.C. § 1334 and the Order of Reference entered by the U.S. District Court for this District entered August 15, 1984. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A) (matters concerning the administration of the estate).

Dismissal under Section 105

that it should dismiss this case using its equitable powers under section 105, arguing that this case is abusive and filed in bad faith. The Court will not invoke section 105 to dismiss this case when a more specific code section - section 1112 governs dismissal of chapter 11 cases. Section 1112 applies in subchapter V cases as well as in regular chapter 11 cases.³⁶ This Court will follow the Supreme Court's guidance from RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 645, 132 S.Ct. 2065, 182 L.Ed.2d 967 (2012). RadLAX states, "[I]t is a commonplace of statutory construction that the specific governs the general." Id. at 645, 132 S.Ct. 2065. Further, as will be more fully explained, the Court is not at liberty to disregard Carolin Corp.'s binding command of a two-prong test for dismissal of chapter 11 cases. Without subjective bad faith and objective futility, dismissal is not proper under this Circuit's binding precedent.

Dismissal for Lack of Subchapter V Eligibility

The Court next turns to the subchapter V eligibility question. The Lessors assert that the Debtor is not eligible for subchapter V because its noncontingent liquidated liabilities exceed the subchapter V debt limits of \$7,500,000.37 The Debtor disagrees arguing that the Lease liabilities are contingent because they are not yet owing and alternatively argues that the Court should look to what will be the *485 capped rejection damages in this case to determine subchapter V eligibility. For the reasons that follow, the Court finds that the Lease obligations are noncontingent and liquidated for purposes of subchapter V eligibility and therefore the Debtor is over the debt limits for subchapter V.

37 11 U.S.C. § 1182(1).

While the parties have not cited to any cases directly on point on this issue, the Court finds that the case of In re Parking Mgmt., 620 B.R. 544 (Bankr. D. Md. 2020) is instructive. The Court begins by noting that the liabilities at issue in *Parking* Mgmt. were not just liability under leases like we have here, and the question before that court was whether lease rejection claims were contingent or noncontingent. Instead, Parking Mgmt. involved lease rejection claims and liability under a "PPP" loan. 38 The *Parking* court found that the lease rejection claims at issue were contingent because they required court approval of the rejection (which occurred after the petition date) in order to fix the rejection claim, and therefore, the debtor's liability thereunder. The Parking court also found [2] The Court first addresses the Lessors' argument that the PPP loan liability was contingent in nature because the PPP loan, created under the CARES Act, allowed for complete forgiveness if the borrower met certain conditions. As the Parking court noted, the primary feature of a PPP loan is forgiveness, rendering liability thereunder contingent because it depended on a future event that may or may not occur.³⁹ The issue in this case is whether the Court should consider the full liability under the Leases and whether the timing of payments thereunder renders that full liability contingent, or whether the Court should allow the estimated lease rejection damages to control.

- 38 In re Parking Mgmt., 620 B.R. 544, 547 (Bankr. D. Md. 2020).
- 39 In re Parking Mgmt., 620 B.R. at 556; In re Parking Mgmt., 620 B.R. at 560.

While the Parking court did not include lease rejection damages in the subchapter V eligibility calculation as those damages were contingent in nature, and did not otherwise analyze the full liability under those leases, that does not mean this Court will ignore the Debtor's existing pre-petition liability under the Leases in favor of post-petition events when determining eligibility. Further, while the Debtor only scheduled what it considered to be the capped rejection

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damages under the Leases, that is not the end of the inquiry, because the evidence before the Court establishes that absent such rejection, the Debtor owes \$14,390,820 under the Leases. Indeed, the *Parking* court held that postpetition events should not be used to determine eligibility for subchapter V. As that court pointed out:

[4] "In considering whether the [debt] is contingent, the court considers whether "all of the events necessary to give rise to liability [took] place prior to filing the petition," or whether "liability relies on some future extrinsic event which may never occur."

40 In re Parking Mgmt., 620 B.R. 544, 556 (Bankr. D. Md. 2020) (internal citation omitted).

[5] This Court agrees with the logic of *Parking Mgmt.*⁴¹ In this case, the debt at issue is liability under the Leases, and that liability arose pre-petition, on the dates the Leases were fully executed. For example, it could not be said that if the Debtor vacated the premises on the 31st of one *486 month during the lease term, that it would not still owe the landlord for the next month and the remainder of the lease term. While it may be argued that the timing of payments is the future extrinsic event that may never occur, the Court disagrees. The timing of lease payments is simply that - timing. Absent the end of the world, we know the future date will occur. As a result, liability under the Leases must be considered noncontingent and liquidated, and the Debtor in this case is therefore above the debt limits for subchapter V, which are capped at \$7.5 million of aggregate noncontingent liquidated debts.⁴²

The Court agrees with the proposition that post-petition events should not control the question of eligibility, but disagrees that a court should look to rejection damages (as opposed to the existing pre-petition liability under the lease) to measure whether a Debtor is eligible for subchapter V.

42 11 U.S.C. § 1182(1)(A).

[6] The Debtor in its reply to the Motion to Dismiss requested revocation of the subchapter V designation in the event the Court finds Macedon to be ineligible and asserts that dismissal would not be the proper remedy for such ineligibility. The Court agrees. This Court has previously revoked a subchapter V designation where the debtor was ineligible, and so has the bankruptcy court for the District of Columbia. It seems that the only parties who would be better off from a dismissal of the case would be the

Lessors; however, the Court is required to consider the effect of dismissal on the estate and other stakeholders as well. In this case, the Court does not see how these other stakeholders would be better off with a dismissal. As a result, the Court will revoke the subchapter V designation in this case, in essence converting it to a regular chapter 11 case. Conversion means the Court need not reach the Debtor's invitation to apply a standard other than the Fourth Circuit's *Carolin Corp.* standard to the case.

43 *In re Berkson*, Case No. 22-10825, Docket No. 113; *In re Nat'l Small Bus. All.*, 642 B.R. 345 (Bankr. D.D.C. 2022).

Dismissal under Carolin Corp.

The Court now turns to whether the Lessors have shown that the Debtor filed this case in subjective bad faith and that the case is objectively futile. As previously stated, the Fourth Circuit's standard for dismissing a chapter 11 case for lack of good faith requires that both objective futility and subjective bad faith be shown. In *Carolin Corp*. the Fourth Circuit explained,

This means that if the only question raised is whether a reorganization is realistically possible, i.e., if there is no question of the petitioner's subjective good faith in filing, threshold dismissal of a petition is not warranted. In those circumstances the question of ultimate futility is better left to post-petition developments. By the same token, even if subjective bad faith in filing could properly be found, dismissal is not warranted if futility cannot also be found. 44

[7] Lessors' counsel readily admitted in response to the Debtor's motion for a directed verdict that the Lessors had not made a showing under the objective futility prong, but instead rely on the Debtor's previously stated "Carolin Corp.-alternative" theories for dismissal. Here, the Debtor has already proposed a 100% repayment to creditors (when accounting for rejection of the Leases). While there may be some tweaks to that plan hereafter, the Court cannot find that the restructuring in this case is objectively futile. Putting aside *487 the Lessors' fatal failure to prove objective futility, the Court will now address the Lessors' showing on subjective bad faith.

- 44 *Carolin Corp. v. Miller*, 886 F.2d 693, 700–01 (4th Cir. 1989).
- Transcript 213:19-22 ("I did not put on any evidence on objective futility because my argument to the Court

in our motion, Your Honor, was that prong of Carolin Corporation should be revisited by the courts.").

[8] The Court notes that it found Mr. Rosenfeld to be a credible witness who gave clear and consistent testimony. The Court also notes that the documentary evidence (particularly the various email chains) submitted in this case did not provide much aid in the decisional process. It is clear from Mr. Rosenfeld's testimony that the events precipitating this bankruptcy filing were multi-faceted and that Macedon's actions in response to those events were not done with subjective bad faith toward the Lessors, nor were they designed to be an abuse of or improper use of the Bankruptcy Code.

First, the Lessors have asserted that Mr. Rosenfeld's various distributions from the Company prior to the filing were evidence of his bad faith. The Lessors essentially assert that the principal was looting the Company. The Court finds that assertion to be without evidentiary support. The testimony and evidence before the Court establish that Mr. Rosenfeld took various distributions from the Debtor as compensation and in order to satisfy tax obligations that he incurred as a result of operating the business. No evidence was presented to establish that these distributions were made for anything other than compensation and the payment of taxes. In fact, the evidence establishes that Mr. Rosenfeld stopped taking distributions to build up a war chest of retained earnings in preparation for acquiring a competitor and profits were taken only after an acquisition target was not identified.⁴⁶ The evidence does not establish that these distributions were taken in order to machinate artificial financial distress for a bankruptcy filing. On the contrary, the testimony of both Mr. Davis and Mr. Rosenfeld is that the Debtor had a drop in revenue, 47 that the Debtor had leased space that became burdensome to its business⁴⁸ and that the Debtor would deplete its necessary cash reserves if the course was not corrected.49

- 46 Transcript 135:17-20; Transcript 135:21-25; Transcript 136:19-24.
- 47 Transcript 224:16-18; 227:1-7.
- 48 Transcript 104:20-25; 105:1-4.
- 49 Transcript 236:16-21; 237:3-9; Transcript 291:3-20.

The Lessors otherwise assert that the Debtor filed this case in bad faith solely to invoke the cap on rejection damages under section 502(b)(6) of the Bankruptcy Code. Lessors have not

provided authority indicating that using the Bankruptcy Code exactly as it was intended renders a filing to be one made in bad faith. Mr. Rosenfeld credibly testified that the Debtor attempted to market and sublease the spaces at issue but it was not able to accomplish that goal. ⁵⁰ There is some dispute between the Debtor and the Lessors as to who was really responsible for the lack of success in the sublease/assignment process, but regardless of where the sticking point was, the Court finds that the breakdown in those negotiations does not indicate a lack of good faith on the part of Macedon. This Debtor is merely one of many debtors that end up in chapter 11 seeking to reject leases that are burdensome to the estate. This is not the first debtor to exercise such business judgment (see essentially any large retail case) and it will not be the last. Further, Mr. Rosenfeld credibly testified regarding the reduced need for the leased office space given the change in circumstances with the Debtor's customers, the COVID pandemic and the Debtors' employees. *488 ⁵¹ Mr. Davis also credibly corroborated that the Debtor will not be able to produce positive cash flow if the Leases are paid according to terms, resulting in approximately nine million dollars in operational losses over the life of the projections in Exhibit 2.0 of the Davis Expert Report. In short, if the course is not changed, the Company will only be able to meet its obligations and maintain necessary working capital through February of 2026. In other words, the company will run out of the cash necessary to operate its business in February 2026 if the Leases are not rejected.

- Transcript 153-154.
- Transcript 224:16-18; 227:1-7; Transcript 104:20-25; 105:1-4; Transcript 236:16-21; 237:3-9; Transcript 291:3-20.

Ultimately, the Court cannot find that the evidence before it establishes subjective bad faith. Instead, the Court sees a landscape of economic uncertainty and a debtor seeking to limit its liabilities and pay its creditors what they're entitled to under the Bankruptcy Code so that it can service its debt, pay and retain its employees, pay trade creditors *and* turn a profit. The desire to do so is not bad faith on the part of the Debtor.

Conclusion

Based on the foregoing, the Court finds that the Lessors have failed to prove subjective bad faith and objective futility in this case. As a result, the Court will deny the Motion to Dismiss. The Court's ruling on the full merits of the case

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moots the need for a decision on the Debtor's motion for directed verdict.

demonstrates a reasonable exercise of the Debtor's business judgment.

[9] Finally, the Lessors' sole ground for objecting to rejection of the Leases has been the pending Motion to Dismiss. Having denied the Motion to Dismiss, and after review of the papers filed by the parties on this issue, the Court will grant the Debtor's Motion to Reject the Leases. The Court finds the Debtor's decision to reject under the facts of this case

Separate Orders will issue.

All Citations

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End of Document

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KeyCite Yellow Flag - Negative Treatment

Disagreed With by In re Bushyhead, N.D.Okla., May 25, 2016

719 F.3d 1253

United States Court of Appeals, Eleventh Circuit.

In re Craig PIAZZA, Debtor. Craig Piazza, Plaintiff–Appellant,

Nueterra Healthcare Physical Therapy, LLC, Defendant–Appellee.

No. 12–12899.

June 26, 2013.

Synopsis

Background: Judgment creditor moved to dismiss case as abuse of provisions of Chapter 7 and for bad faith under "for cause" dismissal provision. The United States Bankruptcy Court for the Southern District of Florida, No. 10–40807–JKO, John K. Olson, J., 451 B.R. 608, dismissed case "for cause" on bad faith grounds, and subsequently denied debtor's motion for rehearing, 460 B.R. 322. Debtor appealed. The District Court, No. 0:11–cv–62569–KMM, K. Michael Moore, J., 469 B.R. 388, affirmed. Debtor appealed.

Holdings: The Court of Appeals, Black, Circuit Judge, held that:

- [1] addressing a question of first impression for the court, a Chapter 7 debtor's prepetition bad faith constitutes "cause" for dismissal;
- [2] in determining bad faith, the bankruptcy court applied the proper, "totality of the circumstances" standard; and
- [3] under the totality of the circumstances, the bankruptcy court's finding of bad faith in this case was not clearly erroneous.

Affirmed.

West Headnotes (42)

[1] Bankruptcy Proceedings; Motion or Sua Sponte Action

Bankruptcy courts may dismiss Chapter 7 cases sua sponte "for cause" in the absence of a motion, so long as the court does not solely invoke the third subsection of the Bankruptcy Code's "for cause" dismissal provision, which requires a motion by the United States Trustee (UST) to dismiss a case for the debtor's failure to file required information. 11 U.S.C.A. § 707(a), (a) (3).

2 Cases that cite this headnote

[2] Bankruptcy Scope of review in general

In a bankruptcy appeal, the Court of Appeals sits as the second court of review of the bankruptcy court's judgment.

23 Cases that cite this headnote

[3] Bankruptcy Conclusions of law; de novo review

Bankruptcy 🧽 Clear error

In a bankruptcy appeal, the Court of Appeals, like the district court, reviews a bankruptcy court's findings of fact for clear error and its conclusions of law de novo.

38 Cases that cite this headnote

[4] Bankruptcy - Good Faith; Motive

Debtor's prepetition bad faith constitutes "cause" for involuntary dismissal of Chapter 7 case. 11 U.S.C.A. § 707(a).

33 Cases that cite this headnote

[5] Statutes 🤛 Language

Courts begin interpretation of a statute with its text

1 Case that cites this headnote

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[6] Bankruptcy 🗽 Cause in general

Enumerated examples of "cause" set forth in the Bankruptcy Code's Chapter 7 "for cause" dismissal provision are illustrative, not exhaustive. 11 U.S.C.A. § 707(a).

4 Cases that cite this headnote

[7] Statutes • Undefined terms

In the absence of a statutory definition, courts interpret phrases in accordance with their ordinary meaning.

1 Case that cites this headnote

[8] Bankruptcy 🕪 Construction and Operation

In determining the ordinary meaning of statutory phrases in the Bankruptcy Code, courts look to dictionary definitions.

2 Cases that cite this headnote

[9] Bankruptcy 🕪 Cause in general

In applying the Bankruptcy Code's Chapter 7 "for cause" dismissal provision, courts adhere to the ordinary meaning of "cause," as authorizing dismissal when adequate or sufficient reason exists for such an action. 11 U.S.C.A. § 707(a).

6 Cases that cite this headnote

[10] Statutes General and specific terms and provisions; ejusdem generis

"Ejusdem generis" canon of statutory construction applies when general words follow an enumeration of specific items or classes.

1 Case that cites this headnote

[11] Statutes Associated terms and provisions; noscitur a sociis

When general language, such as "including," precedes specific examples in a statute, the appropriate canon of statutory construction to apply is "noscitur a sociis," or the associated-words canon.

2 Cases that cite this headnote

[12] Bankruptcy - Good Faith; Motive

Bankruptcy Grounds or cause in general; bad faith

"For cause" in the Bankruptcy Code's Chapter 11 and Chapter 13 dismissal provisions includes bad faith or a lack of good faith. 11 U.S.C.A. §§ 1112(b), 1307(c).

19 Cases that cite this headnote

[13] Bankruptcy — Construction and Operation

Bankruptcy Code must, when possible, be interpreted such that equivalent words have equivalent meaning.

[14] Bankruptcy — Good Faith; Motive

Bankruptcy 🤛 Good Faith; Motive

Bankruptcy Adjustment of Debts of Family Farmer

Bankruptcy 🤛 Good faith in general

Bad faith is pertinent in all chapters of the Bankruptcy Code, regardless of whether a provision contains an explicit good-faith filing requirement.

2 Cases that cite this headnote

[15] Statutes 🕪 Superfluousness

Courts must, when possible, interpret statutory language so as to give effect to each provision.

1 Case that cites this headnote

[16] Statutes • Construing together; harmony

Redundancies across statutes are not unusual events in drafting, and where there is no "positive repugnancy" between two subsections, the court must give effect to both.

2 Cases that cite this headnote

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[17] Bankruptcy Consumer debt abuse Bankruptcy Cause in general

Subsections (a) and (b) of the Bankruptcy Code's Chapter 7 "for cause" dismissal provision cover different types of debt; subsection (b) governs dismissal of petitions involving "primarily consumer debts," while subsection (a) contains no such limitation and on its face governs dismissal of consumer and non-consumer debts. 11 U.S.C.A. § 707(a, b).

[18] Bankruptcy Proceedings; Motion or Sua Sponte Action

Once a presumption that dismissal is warranted is established, a Chapter 7 debtor must produce highly specific evidence to rebut the presumption of abuse. 11 U.S.C.A. § 707(b), (b)(2)(B).

1 Case that cites this headnote

[19] Bankruptcy Proceedings; Motion or Sua Sponte Action

Movant always bears the burden of showing "cause" for dismissal of a Chapter 7 case. 11 U.S.C.A. § 707(a).

1 Case that cites this headnote

[20] Bankruptcy Consumer debt abuse Bankruptcy Cause in general

Although the Chapter 7 "abuse" dismissal provision provides not only for dismissal, but also for conversion of a Chapter 7 petition to Chapter 11 or 13 with the debtor's consent, the remedies in the "for cause" dismissal provision are limited to dismissal. 11 U.S.C.A. § 707(a, b).

1 Case that cites this headnote

[21] Statutes General and specific terms and provisions; ejusdem generis

Although specific statutory provisions often "trump" more general ones, this presumption is not an absolute rule; rather, the "general/specific canon" is simply an indication of statutory

meaning that can be overcome by textual indications that point in the other direction.

2 Cases that cite this headnote

[22] Bankruptcy ← Consumer debt abuse Bankruptcy ← Cause in general

That parties might have two options, one specific and one general, for combating abusive bankruptcy practices is no reason for judges to rewrite either option to be more lenient than the text's ordinary meaning would suppose. 11 U.S.C.A. § 707(a, b).

1 Case that cites this headnote

[23] Statutes Express mention and implied exclusion; expressio unius est exclusio alterius

When Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.

1 Case that cites this headnote

[24] Statutes Absent terms; silence; omissions

Courts are not to draw sweeping inferences from congressional silence when such inferences are contrary to all other textual and contextual evidence of congressional intent.

1 Case that cites this headnote

[25] Statutes Express mention and implied exclusion; expressio unius est exclusio alterius

In construing a statute, the inference that items not mentioned were excluded by deliberate choice has force only when the items expressed are members of an associated group or series.

[26] Statutes Presumptions

When it is evident an amended provision of a statute was not modeled after the earlier one and is couched in very different terms, the selective inclusion presumption is less persuasive, and

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cannot overcome the ordinary meaning of statutory language.

[27] Bankruptcy 📂 Discretion

Bankruptcy court commits an "abuse of discretion" when it applies the wrong principle of law or makes clearly erroneous findings of fact.

9 Cases that cite this headnote

[28] Bankruptey Conclusions of law; de novo review

Bankruptcy Particular cases and issues

Legal standard by which the bankruptcy court finds bad faith, for Chapter 7 dismissal purposes, is a question of law reviewed de novo, while the court's finding of bad faith itself is a factual determination that is reviewed only for clear error. 11 U.S.C.A. § 707(a).

6 Cases that cite this headnote

[29] Bankruptcy 🕪 Cause in general

Bad faith does not lend itself to a strict formula, for Chapter 7 dismissal purposes; instead, it is a fact-intensive judgment that is subject to judicial discretion under the circumstances of each case. 11 U.S.C.A. § 707(a).

8 Cases that cite this headnote

[30] Bankruptcy Sood Faith; Motive

In light of its inherently discretionary nature, a "totality of the circumstances" approach is the correct legal standard for determining bad faith under the Chapter 7 "for cause" dismissal provision. 11 U.S.C.A. § 707(a).

13 Cases that cite this headnote

[31] Bankruptcy — Good Faith; Motive

"Totality of the circumstances" inquiry for bad faith, for Chapter 7 dismissal purposes, looks for "atypical" conduct that falls short of the honest and forthright invocation of the Bankruptcy Code's protections. 11 U.S.C.A. § 707(a).

9 Cases that cite this headnote

[32] Bankruptcy 🕪 Good Faith; Motive

Bankruptcy ightharpoonup Abuse of bankruptcy process

Among other considerations that might indicate bad faith are a Chapter 7 debtor's intent to abuse the judicial process, intentional efforts to delay or frustrate legitimate creditors, practice of deliberately racking up debts he has no ability to repay and then seeking to shield himself from creditors through bankruptcy, having noneconomic motives, including to frustrate a divorce court decree or force an ex-spouse into bankruptcy, making every effort to avoid payment of an obligation despite being capable of at least partial repayment, having primarily a single creditor, failing to make significant lifestyle adjustments or efforts to repay, and having a disproportionate debt-to-income ratio in the absence of a marked calamity or sudden loss of income. 11 U.S.C.A. § 707(a).

2 Cases that cite this headnote

[33] Bankruptcy — Good Faith; Motive

In determining a Chapter 7 debtor's bad faith, for dismissal purposes, bankruptcy courts must, as they so often do, sift the circumstances surrounding a claim to see that injustice or unfairness is not done. 11 U.S.C.A. § 707(a).

4 Cases that cite this headnote

[34] Bankruptcy 🌦 Abuse of bankruptcy process

For dismissal purposes, a Chapter 7 debtor's bad faith is ultimately evidenced by the debtor's deliberate acts or omissions that constitute a misuse or abuse of the provisions, purpose, or spirit of the Bankruptcy Code. 11 U.S.C.A. § 707(a).

16 Cases that cite this headnote

[35] Bankruptcy Sood Faith; Motive

"Totality of the circumstances" approach for determining bad faith, for Chapter 7 dismissal

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purposes, does not amount simply to a "sniff test." 11 U.S.C.A. § 707(a).

5 Cases that cite this headnote

[36] Bankruptcy - Order; prejudice

As with the determination of bad faith in other contexts, a conclusory finding of bad faith, for Chapter 7 dismissal purposes, is not sufficient to withstand appellate review; rather, the bankruptcy court must articulate reasoned bases and make adequate factual findings to support its determination. 11 U.S.C.A. § 707(a).

[37] Bankruptcy ← Good Faith; Motive Bankruptcy ← Order; prejudice

Bankruptcy court did not apply an erroneous legal standard in dismissing Chapter 7 debtor's case for bad faith where the court examined relevant facts of case to determine debtor's "intentions" and whether he was "an honest but unfortunate debtor entitled to a fresh start," and then, concluding that the totality of the circumstances revealed bad faith, articulated reasoned bases for its finding of bad faith and explained that finding in terms of indisputable record evidence. 11 U.S.C.A. § 707(a).

4 Cases that cite this headnote

[38] Bankruptcy → Proceedings; Motion or Sua Sponte Action

Constitutional Law 👺 Bankruptcy

Chapter 7 debtor, whose case was dismissed for bad faith under the "for cause" dismissal provision, was not denied "minimal procedural due process" where debtor was clearly on notice of judgment creditor's motion to dismiss for bad faith and, when asked by the bankruptcy court whether an evidentiary hearing was necessary, debtor's counsel confidently declared, "[n]ot at all, Your Honor." 11 U.S.C.A. §§ 102(1)(A), 707(a).

10 Cases that cite this headnote

[39] Bankruptcy 🕪 Clear error

Bankruptcy court's factual finding is "clearly erroneous" only when the appellate court, after reviewing all of the evidence, is left with the definite and firm conviction that a mistake has been committed.

13 Cases that cite this headnote

[40] Bankruptcy 🕪 Clear error

"Definite and firm conviction" that a mistake has been committed, as required for an appellate court to find a bankruptcy court's factual finding "clearly erroneous," arises only when there has been a manifest disregard of right and reason.

11 Cases that cite this headnote

[41] Bankruptcy ← Good Faith; Motive Bankruptcy ← Proceedings; Motion or Sua Sponte Action

Finding that Chapter 7 debtor filed his petition in bad faith, as warranted dismissal of case, was supported by evidence that debtor filed bankruptcy to avoid paying a large single debt arising from a state-court judgment he evaded for more than two years, that despite his debts to judgment creditor and others debtor continued paying the debts of insiders and transferred thousands of dollars every month to his wife, that debtor failed to make life-style adjustments, and that debtor did not pay his debts to creditors, even though both he and his wife earned "substantial income" and could have repaid at least a portion of those debts. 11 U.S.C.A. § 707(a).

6 Cases that cite this headnote

[42] Bankruptcy ← Good Faith; Motive Bankruptcy ← Cause in general

Although bankruptcy courts may not rely solely upon a Chapter 7 debtor's ability to pay to the exclusion of all other considerations, a debtor's resources is one relevant indicator, among many, of bad faith or "cause" to dismiss. 11 U.S.C.A. § 707(a).

1

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1 Case that cites this headnote

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Appeal from the United States District Court for the Southern District of Florida.

Before MARCUS, BLACK and SILER, * Circuit Judges.

* Honorable Eugene E. Siler, Jr., United States Circuit Judge for the Sixth Circuit, sitting by designation.

Opinion

BLACK, Circuit Judge:

Craig Piazza appeals the district court's order affirming the bankruptcy court's dismissal of his Chapter 7 bankruptcy petition for bad faith under 11 U.S.C. § 707(a). Piazza contends the bankruptcy court erred because § 707(a) permits dismissal only "for cause" and prepetition bad faith does not constitute "cause" for dismissal. In the alternative, Piazza argues, even if bad faith does provide "cause" for involuntary dismissal under § 707(a), the record does not support the bankruptcy court's finding of bad faith in this case. We affirm the district court's affirmance of the bankruptcy court's order.

I. FACTS AND PROCEDURAL HISTORY

Piazza voluntarily filed for Chapter 7 bankruptcy on October 8, 2010, seeking to discharge debts he identified as primarily business related. Piazza also filed Schedules A–J¹ and other documents describing his income and debts. According to Piazza's Schedule F, his unsecured debt totaled roughly \$319,683. More than half of that debt, approximately \$161,383 not including interest, was owed to a single

creditor: Appellee, Nueterra Healthcare Physical Therapy, LLC (Nueterra).

Schedule A (Real Property); Schedule B (Personal Property); Schedule C (Property Claimed as Exempt); Schedule D (Creditors Holding Secured Claims); Schedule E (Creditors Holding Unsecured Priority Claims); Schedule F (Creditors Holding Unsecured Nonpriority Claims); Schedule G (Executory Contracts and Unexpired Leases); Schedule H (Codebtors); Schedule I (Current Income of Individual Debtor); and Schedule J (Current Expenditures of Individual Debtor). Piazza subsequently filed amended versions of Schedules, B, C, I, and J.

In January 2011, Nueterra moved the bankruptcy court to dismiss Piazza's case. Nueterra's motion revealed that Piazza's debt arose from a state court judgment entered against him for failure to pay a business guarantee, and that it had attempted to collect on that judgment without success for over two years. Frustrated with Piazza's recalcitrance, the state court demanded he produce documents justifying his failure to pay by October 9, 2010, or face adverse presumptions at subsequent hearings. According to Nueterra, Piazza's bankruptcy filing on October 8, 2010, was simply an effort to avoid paying the state court judgment. Nueterra argued that, on the "totality of the circumstances," Piazza's Chapter 7 petition should be dismissed for bad faith.

In response, Piazza acknowledged that his debt to Nueterra "may well have been *1259 the motivating factor for filing bankruptcy" when he did. But, Piazza argued, "[f]iling bankruptcy to avoid a garnishment is common practice and hardly justifies a claim of bad faith." Piazza contended that because Nueterra's state-court claim did not allege fraud, and because the state court judgment was the result of a default rather than "vexatious litigation," the bankruptcy court should not find bad faith.

[1] After hearing oral argument, the bankruptcy court granted Nueterra's motion to dismiss, concluding that "cause" existed to dismiss Piazza's case pursuant to § 707(a) based on bad faith. *In re Piazza (Piazza I)*, 451 B.R. 608, 616–17 (Bankr.S.D.Fla.2011). Although Nueterra's motion relied primarily on § 707(b) rather than § 707(a),² the bankruptcy court found Nueterra's "totality of the circumstances arguments ... implicitly ask [ed] the court to dismiss this case" for "cause" under subsection (a). *Id.* at 611. Additionally, the bankruptcy court determined that the finding of bad faith should be guided by a list of fifteen non-

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dispositive factors. Under that framework, bad faith may be found when:

- 2 It is not relevant to the outcome of this appeal that Nueterra's motion to the bankruptcy court relied principally upon 11 U.S.C. § 707(b) rather than § 707(a). First, Nueterra's motion expressly references "a debtor's bad faith" providing grounds "to dismiss a chapter 7 case for cause under § 707(a)." Second, dismissal under § 707(a) was raised before the bankruptcy court at oral argument. Third, § 707(a) authorizes dismissal "for cause" and, with the exception of § 707(a)(3), does not require that a "party in interest" request dismissal. See 11 U.S.C. § 707(a)(3) (requiring "a motion by the United States trustee" to dismiss for "failure of the debtor in a voluntary case to file ... the information required by" 11 U.S.C. § 521(a)(1)). Therefore, bankruptcy courts may dismiss cases sua sponte "for cause" in the absence of a motion, so long as the court does not solely invoke § 707(a)(3). Cf. Walden v. Walker (In re Walker), 515 F.3d 1204, 1212 (11th Cir.2008) (holding that 11 U.S.C. § 324 authorizes bankruptcy courts to remove a trustee sua sponte because that statute permits dismissal "for cause" and "does not require that a 'party in interest' request the removal").
 - (i) the debtor reduced his creditors to a single creditor shortly before the petition date;
 - (ii) the debtor made no life-style adjustments or continued living a lavish life-style;
 - (iii) the debtor filed the case in response to a judgment, pending litigation, or collection action;
 - (iv) there is an intent to avoid a large, single debt;
 - (v) the debtor made no effort to repay his debts;
 - (vi) the unfairness of the use of Chapter 7;
 - (vii) the debtor has sufficient resources to pay his debts;
 - (viii) the debtor is paying debts of insiders;
 - (ix) the schedules inflate expenses to disguise financial well-being;
 - (x) the debtor transferred assets;

- (xi) the debtor is over-utilizing the protections of the Bankruptcy Code to the unconscionable detriment of creditors;
- (xii) the debtor employed a deliberate and persistent pattern of evading a single major creditor;
- (xiii) the debtor failed to make candid and full disclosure;
- (xiv) the debtor's debts are modest in relation to his assets and income; and
- (xv) there are multiple bankruptcy filings or other procedural "gymnastics."

Id. at 614–15 (quoting *In re Baird*, 456 B.R. 112, 116–17 (Bankr.M.D.Fla.2010)).

Applying those factors, the bankruptcy court found bad faith based on six of the *1260 fifteen criteria. First, factors (iii), (iv), (viii), and (xii) supported a finding of bad faith, as Piazza filed bankruptcy "in response to," and in order "to avoid," Nueterra's state-court judgment—a "large, single debt" Piazza had "deliberate[ly] and persistent[ly]" evaded while at the same time "paying debts of insiders." *Piazza I*, 451 B.R. at 616. Piazza's debt to Nueterra was substantially larger than those he owed to other creditors. Out of more than \$319,000 in total debt, Piazza owed Nueterra \$161,383. By comparison, Piazza's next largest debt was a \$51,948 non-dischargeable student loan. Also, while evading the state-court judgment for more than two years, Piazza "transfer[red] significant amounts to his wife" and paid his great aunt's mortgage. *Id.* at 616.

Second, factors (ii) and (vii) supported a finding of bad faith, because Piazza "failed to make life-style adjustments" and "had sufficient resources to pay his debts." *Id.* at 616–17. Regardless of whether Piazza's lifestyle was "lavish," it was uncontroverted he had made no adjustments despite his substantial debt to Nueterra. *Id.* at 617. Additionally, it was clear Piazza had the "ability to repay at least a portion of his debts" considering he leased a luxury vehicle and "transferred thousands of dollars to his wife which could have been used to repay his creditors." *Id.* In the court's view, Piazza's bankruptcy petition was not the result of a "sudden financial disaster" or "medical crisis" but rather "was timed perfectly to" impede Nueterra's collection efforts on the state-court judgment. *Id.* at 616.

Following the bankruptcy court's order, Piazza moved for rehearing. The bankruptcy court denied that motion,

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reaffirming its initial holding that bad faith constitutes "cause" for dismissal under § 707(a) and that its factual finding of bad faith was not manifestly erroneous. *See In re Piazza (Piazza II)*, 460 B.R. 322, 328 (Bankr.S.D.Fla.2011). Subsequently, the district court affirmed the bankruptcy court on all issues. *Piazza v. Nueterra Healthcare Physical Therapy, LLC (Piazza III)*, 469 B.R. 388, 389 (S.D.Fla.2012). This appeal followed.

II. DISCUSSION

[2] [3] In a bankruptcy appeal, we sit as the second court of review of the bankruptcy court's judgment. *Equitable Life Assur. Soc'y v. Sublett (In re Sublett)*, 895 F.2d 1381, 1383–84 (11th Cir.1990). Like the district court, we review a bankruptcy court's findings of fact for clear error and its conclusions of law de novo. *Englander v. Mills (In re Englander)*, 95 F.3d 1028, 1030 (11th Cir.1996).

A. Prepetition Bad Faith and "For Cause" Dismissal under § 707(a)

- [4] The threshold issue in this case is whether prepetition bad faith constitutes "cause" to dismiss involuntarily a Chapter 7 petition under § 707(a). This is a question of first impression in the Eleventh Circuit, and one that has divided our sister circuits. We conclude that, based on the *1261 ordinary meaning of the statutory language and relevant principles of statutory construction, the power to dismiss "for cause" in § 707(a) includes the power to involuntarily dismiss a Chapter 7 case based on prepetition bad faith.
- 3 Compare Tamecki v. Frank (In re Tamecki), 229 F.3d 205, 207 (3d Cir.2000) (holding "cause" under § 707(a) permits a dismissal based on bad faith), and Dinova v. Harris (In re Dinova), 212 B.R. 437, 442 (2d Cir. BAP 1997) (suggesting, but not explicitly holding, that "for cause" dismissal under § 707(a) could include a lack of "good faith" and should be determined on a "case by case" basis to determine if "an abuse constituting cause has occurred"), and Indus. Ins. Servs., Inc. v. Zick (In re Zick), 931 F.2d 1124, 1129 (6th Cir.1991) (holding "cause" under § 707(a) includes bad faith), with Neary v. Padilla (In re Padilla), 222 F.3d 1184, 1193–94 (9th Cir.2000), partially superseded by statute on other grounds, Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. No. 109-8, 119 Stat. 23 (rejecting "the 'bad faith' label in favor of simply examining the actions of the debtor that are

complained of" and determining whether "cause" exists to dismiss under § 707(a)), and Huckfeldt v. Huckfeldt (In re Huckfeldt), 39 F.3d 829, 832 (8th Cir.1994) (holding that, although many grounds for dismissal under § 707(a) may be characterized as "bad faith," "bad faith" should not be a free-standing "cause" for dismissal).

1. The Ordinary Meaning of For Cause

[5] We begin our interpretation of a statute with its text. *Harris v. Garner*, 216 F.3d 970, 972–73 (11th Cir.2000) (en banc). Section 707(a) provides that a bankruptcy court "may dismiss a case under this chapter only after notice and a hearing and only *for cause*, including"—

- (1) unreasonable delay by the debtor that is prejudicial to creditors;
- (2) nonpayment of any fees or charges required under chapter 123 of title 28; and
- (3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521(a), but only on a motion by the United States trustee.

 11 U.S.C. § 707(a) (emphasis added).
- [8] The Bankruptcy Code does not define "for [6] cause," and the three enumerated examples in § 707(a) are illustrative, not exhaustive. See, e.g., 11 U.S.C. § 102(3) (defining "including," for purposes of the Bankruptcy Code as "not limiting"); see also Dionne v. Simmons (In re Simmons), 200 F.3d 738, 743 (11th Cir.2000) (noting the examples of "cause" are "nonexclusive"). In the absence of a statutory definition, we interpret phrases in accordance with their ordinary meaning. Miss. Band of Choctaw Indians v. Holyfield, 490 U.S. 30, 47, 109 S.Ct. 1597, 1607-08, 104 L.Ed.2d 29 (1989). In determining the ordinary meaning of statutory phrases in the Bankruptcy Code, courts look to dictionary definitions. See, e.g., Ransom v. FIA Card Servs., N.A., — U.S. —, 131 S.Ct. 716, 724, 178 L.Ed.2d 603 (2011); Keppel v. Tiffin Sav. Bank, 197 U.S. 356, 362, 25 S.Ct. 443, 445, 49 L.Ed. 790 (1905).
- [9] When Congress enacted § 707's "for cause" language in 1978, *Black's Law Dictionary* defined "cause," in relevant part, simply as "reason" or "justification." *Black's Law Dictionary* 279 (4th ed. 1968). Subsequent editions of *Black's Law Dictionary* have maintained that basic understanding of "cause." *See, e.g., Black's Law Dictionary* 200 (5th ed. 1979)

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(defining "cause" as "[a] reason for an action" or a "ground of a legal action"). The most recent edition, in particular, defines "for cause" straightforwardly as "[f]or a legal reason or ground." Black's Law Dictionary 717 (9th ed. 2009). This understanding of "cause," moreover, is not limited to legal dictionaries. See, e.g., Funk & Wagnalls College Standard Dictionary 198 (1941) (defining "cause" as "[a]ny rational ground for choice or action; reason"). Non-legal sources from 1978 to the present have consistently defined "cause" as "[g]ood or sufficient reason," American Heritage Dictionary, New College Edition 214 (6th ed. 1976), as "[g]ood, proper, or adequate ground of action," 2 Oxford English Dictionary 1000 (2d ed. 1989), or as "reasonable grounds for doing ... something," New Oxford American Dictionary 272 (3d ed. 2005).

Although these definitions vary in their precise terms, the common thread among them is unmistakable: the ordinary meaning *1262 of "cause" is adequate or sufficient reason. Indeed, this understanding of "cause" comports not only with dictionary definitions but also with judicial understandings of that term. See, e.g., Little Creek Dev. Co. v. Commonwealth Mortg. Corp. (In re Little Creek Dev. Co.), 779 F.2d 1068, 1072 (5th Cir.1986) (explaining that "for cause" in the Bankruptcy Code means "any reason cognizable to the equity power and conscience of the court as constituting an abuse of the bankruptcy process" (citing In re Victory Constr. Co., 9 B.R. 549, 558-60 (Bankr.C.D.Cal.1981), vacated as moot on other grounds by, Hadley v. Victory Constr. Co. (In re Victory Constr. Co.), 37 B.R. 222 (9th Cir. BAP 1984))). Thus, in applying § 707(a), we adhere to the ordinary meaning of "cause," as authorizing dismissal when adequate or sufficient reason exists for such an action.

The next question is whether prepetition bad faith falls within the ordinary meaning of "for cause" under § 707(a)—that is, whether such bad faith is an adequate or sufficient reason to dismiss involuntarily a Chapter 7 petition. We hold that it is. Bad-faith bankruptcy filings significantly burden the legal system in general and bankruptcy courts in particular. In 2012, there were approximately 1.2 million bankruptcy filings in the United States. See U.S. Bankruptcy Courts—Cases Commenced During the 12—Month Period Ending December 31, 2012 (Table F–2), available at http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2012/1212_f2. pdf. Of those, over 840,000 were Chapter 7 filings. See id. Although these numbers do not tell us how many cases were filed in bad faith, they do indicate we should not

artificially limit the tools Congress has given bankruptcy courts to protect their "jurisdictional integrity." *Cf. Little Creek*, 779 F.2d at 1072. Considering bankruptcy courts may sanction litigants for filing documents with "any improper purpose", *see* Fed. R. Bankr.P. 9011(b)(1), as well as "tak[e] any action ... necessary or appropriate ... to prevent an abuse of process," *see* 11 U.S.C. § 105(a), we see no reason why prepetition bad faith should not constitute an adequate or sufficient reason for dismissal. To hold otherwise would "create[] the appearance that such an abusive practice is implicitly condoned by the [Bankruptcy] Code." *Dinova v. Harris (In re Dinova)*, 212 B.R. 437, 441 (2d Cir. BAP 1997) (internal quotation marks omitted).

Accordingly, prepetition bad faith constitutes "cause" for involuntary dismissal under § 707(a), because such conduct provides adequate or sufficient reason to dismiss a debtor's case. *See, e.g., Tamecki v. Frank (In re Tamecki)*, 229 F.3d 205, 207 (3d Cir.2000) (interpreting "cause" under § 707(a) to include bad faith); *Indus. Ins. Servs., Inc. v. Zick (In re Zick)*, 931 F.2d 1124, 1129 (6th Cir.1991) (same).

2. Piazza's Counterarguments to the Ordinary Meaning of "For Cause"

Despite the clear, ordinary meaning of "for cause," Piazza contends prepetition bad faith does not fall within the ambit of § 707(a). In pressing this argument, Piazza invokes several canons of statutory construction. None of them applies in this case.

a. Limiting "For Cause" to its Specific Examples

Piazza argues that, based on the *ejusdem generis* canon of interpretation, prepetition bad faith does not provide "cause" for dismissal under § 707(a), as it is not of the "same kind, class, or nature" as the three specifically enumerated examples. The three examples listed in § 707(a) articulate primarily objective criteria relating to postpetition procedural issues, while prepetition bad faith, Piazza argues, is "amorphous" and subjective. In Piazza's *1263 view, debtors are entitled to bankruptcy under Chapter 7 so long as their "debts were not incurred by prohibited means, and nothing is withheld from the Trustee."

[10] [11] We reject this contention for a number of reasons. First, the specific examples in § 707(a) lend greater support to the conclusion that bad faith *does* fall within the

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meaning of "for cause." See, e.g., McDow v. Smith, 295 B.R. 69, 74–75 (E.D.Va.2003) (reasoning that "a debtor's bad faith falls within the same class as the three illustrative examples of 'cause' enumerated in § 707(a)"). A debtor's "unreasonable delay, failure to pay required fees and failure to meet filing deadlines are all acts or omissions" that, "in the absence of inadvertence or excusable neglect," reflect a debtor's bad faith or "misuse of the bankruptcy process." Id. at 74; see also id. at 75 n. 8 (interpreting bad faith and § 707(a)'s three examples "as intersecting subsets of the set of acts or omissions of a debtor that amount to abuse or misuse of the bankruptcy process"). Therefore, Piazza's reliance on the "kind, class, or nature" of the specific examples in § 707(a) undermines rather than supports his position.

4 As a technical matter, Piazza's reliance on the ejusdem generis canon is misplaced. That principle applies when general words follow an enumeration of specific items or classes. Allen v. Thomas, 161 F.3d 667, 671 (11th Cir.1998) ("Under the ejusdem generis canon of construction, where general words follow a specific enumeration of persons or things, the general words should be limited to persons or things similar to those specifically enumerated." (internal quotation marks omitted)). However, when general language, such as "including," precedes specific examples, the appropriate canon of statutory construction is noscitur a sociis or the associated-words canon. See, e.g., Garcia v. Vanguard Car Rental USA, Inc., 540 F.3d 1242, 1247 (11th Cir.2008) (describing noscitur a sociis as "the commonsense principle that statutory terms, ambiguous when considered alone, should be given related meaning when grouped together"); see also Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 205 (2012) ("In all contexts other than the pattern of specific-to-general, the proper rule to invoke is the broad associated-words canon, not the narrow ejusdem generis canon."). Nevertheless, even applying the appropriate principle of interpretation, Piazza's argument is unavailing.

[12] Second, Piazza's constricted reading of § 707(a) contravenes the settled meaning of "for cause" elsewhere in the Bankruptcy Code. *See, e.g., Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 373, 127 S.Ct. 1105, 1111, 166 L.Ed.2d 956 (2007) ("Bankruptcy courts ... routinely treat dismissal for prepetition bad-faith conduct as implicitly authorized by the words 'for cause.' "). Aside from § 707(a), 11 U.S.C. §§ 1112(b) and 1307(c) permit dismissal "for cause." Those provisions were enacted contemporaneously with § 707 in 1978, and share with § 707(a) similar or identical examples

of "cause" for dismissal. And, as interpreted by the Supreme Court and nearly every federal court of appeals, "for cause" in §§ 1112(b) and 1307(c) includes bad faith or a lack of good faith. See, e.g., Marrama, 549 U.S. at 373–74, 127 S.Ct. at 1111 (interpreting "for cause" under 11 U.S.C. § 1307(c) as encompassing "prepetition bad-faith conduct"); see also *1264 Phoenix Piccadilly, Ltd. v. Life Ins. Co. of Va. (In re Phoenix Piccadilly, Ltd.), 849 F.2d 1393, 1394 (11th Cir.1988) (interpreting "for cause" under 11 U.S.C. § 1112(b) as including a lack of good faith).

- Compare § 707(a)(1), (2) (listing as examples of "cause" for dismissal "(1) unreasonable delay by the debtor that is prejudicial to creditors" and "(2) nonpayment of any fees and charges required under chapter 123 of title 28"), with § 1307(c)(1), (2) (same), and § 1112(b)(4) (F), (K) (listing as examples of "cause" for dismissal "(F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter" and "(K) failure to pay any fees or charges required under chapter 123 of title 28").
 - See, e.g., Jacobsen v. Moser (In re Jacobsen), 609 F.3d 647, 660 (5th Cir.2010) (interpreting "for cause" in 11 U.S.C. § 1307(c) to include situations in which "the debtor has acted in bad faith or abused the bankruptcy process"); Tidewater Fin. Co. v. Williams, 498 F.3d 249, 259 (4th Cir.2007) (equating "for cause" with "bad faith" for purposes of 11 U.S.C. § 362); In re SGL Carbon Corp., 200 F.3d 154, 162 (3d Cir.1999) ("[A] Chapter 11 petition is subject to dismissal for 'cause' under 11 U.S.C. § 1112(b) unless it is filed in good faith."); C-TC 9th Ave. P'ship v. Norton Co. (In re C-TC 9th Ave. P'ship), 113 F.3d 1304, 1309-12 (2d Cir.1997) (holding that bad faith is "cause" to dismiss under § 1112(b)); In re Lilley, 91 F.3d 491, 496 (3d Cir.1996) (reading "for cause" in § 1307(c) as allowing dismissal based on bad faith, even though "Chapter 13 contains no explicit good faith requirement"); Molitor v. Eidson (In re Molitor), 76 F.3d 218, 220-21 (8th Cir.1996) (interpreting "for cause" under § 1307(c) to include dismissal based on "bad faith"); Marsch v. Marsch (In re Marsch), 36 F.3d 825, 828 (9th Cir.1994) (interpreting "for cause" in 11 U.S.C. § 1112(b) as permitting dismissal for "a lack of good faith in filing a Chapter 11 petition" even though § 1112(b) "does not explicitly require that cases be filed in 'good faith' "); Eisen v. Curry (In re Eisen), 14 F.3d 469, 470 (9th Cir.1994) (reading "for cause" in § 1307(c) to include bad faith); Gier v. Farmers State Bank of Lucas, Kan. (In re Gier), 986 F.2d 1326, 1329-30 (10th Cir.1993) (construing "for cause" under § 1307(c) to

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authorize dismissal based on bad faith); Carolin Corp. v. Miller, 886 F.2d 693, 698 (4th Cir.1989) (concluding that "a good faith filing requirement is implicit in several specific provisions of the bankruptcy code"—i.e., those permitting "for cause" dismissal); In re Smith, 848 F.2d 813, 816 n. 3 (7th Cir.1988) (interpreting the "for cause" language of § 1307(c) to include a dismissal premised on a debtor's bad faith in filing the petition); In re Madison Hotel Assocs., 749 F.2d 410, 426 (7th Cir.1984) ("It is generally recognized that ... the lack of ... good faith constitutes 'cause,' sufficient for dismissal under 11 U.S.C. § 1112(b)." (citations omitted)); Sullivan v. Solimini (In re Sullivan), 326 B.R. 204, 211 (1st Cir. BAP 2005) (reaffirming "it is well established that lack of good faith (or bad faith) is 'cause' for dismissal ... under § 1307(c)").

[13] The settled meaning of "for cause" is significant. See, e.g., Ratzlaf v. United States, 510 U.S. 135, 143, 114 S.Ct. 655, 660, 126 L.Ed.2d 615 (1994) ("A term appearing in several places in a statutory text is generally read the same way each time it appears."). As the Supreme Court has held, the Bankruptcy Code must, when possible, be interpreted such that "equivalent words have equivalent meaning." Cohen v. de la Cruz, 523 U.S. 213, 220, 118 S.Ct. 1212, 1217, 140 L.Ed.2d 341 (1998). Interpreting "for cause" in § 707(a) to mean something different than what it means elsewhere in the Bankruptcy Code would create unnecessary incoherence. See, e.g., FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133, 120 S.Ct. 1291, 1301, 146 L.Ed.2d 121 (2000) (noting that courts must interpret statutes as "symmetrical and coherent regulatory scheme[s]"); cf. Hamilton v. Lanning, 560 U.S. 505, 130 S.Ct. 2464, 2475-76, 177 L.Ed.2d 23 (2010) (rejecting an interpretation of the Bankruptcy Code that "would produce senseless results").

Likewise, Piazza's argument against adopting the settled meaning of "for cause" runs counter to both the original understanding of that term in § 707 as well as more than a century of federal bankruptcy law and policy. With only minor exception, the power of bankruptcy courts under § 707 to dismiss "for cause" has, since its enactment, been understood by courts as the power to prevent "manifestly inequitable result[s]." See In re Pagnotta, 22 B.R. 521, 522–23 (Bankr.D.Md.1982) (applying § 707 in a voluntary dismissal case); see also In re Khan, 35 B.R. 718, 719–20 (Bankr.W.D.Ky.1984) (interpreting "for cause" in § 707 to include bad faith); In re Sacramento Metro. Real *1265 Estate Investors, 28 B.R. 228, 229–30 (Bankr.E.D.Cal.1983) (same). But see Neary v. Padilla (In re Padilla), 222 F.3d 1184, 1192–94 (9th Cir.2000) (holding bad faith does not

constitute "cause" for dismissal under § 707(a)), partially superseded by statute on other grounds, Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. No. 109-8, 119 Stat. 23. Additionally, every federal bankruptcy statute since the nineteenth century has "incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings." Little Creek, 779 F.2d at 1071; cf. Neal v. Clark, 95 U.S. 704, 709, 24 L.Ed. 586 (1877) (emphasizing that Congress's "object and intention ... in enacting" bankruptcy laws was to relieve "honest citizen[s] ... from the burden of hopeless insolvency" (emphasis added)). In this case, there is no clear indication that Congress intended the stark departure from "past bankruptcy practice" that Piazza would have this Court adopt. See Cohen, 523 U.S. at 221, 118 S.Ct. at 1218.

Piazza argues, however, that we should abandon the settled meaning of "for cause" in this case because Chapter 7 differs from Chapters 11 and 13. Unlike § 707(a) in Chapter 7, Piazza contends "for cause" in §§ 1112(b) and 1307(c) should include bad faith because Chapters 11 and 13 explicitly require "good faith" and contemplate an ongoing relationship between the debtor and creditor. See 11 U.S.C. § 1129(a)(3) (requiring reformation plans under Chapter 11 to be "proposed in good faith"); § 1325(a)(3) (requiring reformation plans under Chapter 13 to be "proposed in good faith"). By contrast, he argues, Chapter 7 liquidation involves no such relationship, and therefore the debtor's good or bad faith is immaterial.

[14] Although some courts have found this argument persuasive, see Padilla, 222 F.3d at 1193-94, we do not. In Marrama, the Supreme Court made clear bad faith is pertinent in all Chapters of the Bankruptcy Code, regardless of whether a provision contains an explicit good-faith filing requirement. See Marrama, 549 U.S. at 373-75, 127 S.Ct. at 1110-12; see also Rosson v. Fitzgerald (In re Rosson), 545 F.3d 764, 773 n. 12 (9th Cir.2008) (citing Marrama for the proposition that "even otherwise unqualified rights in the debtor are subject to limitation by the bankruptcy court's power under § 105(a) to police bad faith and abuse of process"). Accordingly, there is no basis for Piazza's assertion that bad faith is immaterial in one chapter simply because it is particularly salient in another. Moreover, the absence of an ongoing *post*-petition relationship between the debtor and creditor in Chapter 7 does not in any way suggest a debtor's pre-petition bad faith can never provide "cause" to dismiss. Like §§ 1112(b) and 1307(c), § 707(a)'s specific

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examples "d[o] not preclude consideration of unenumerated factors in determining 'cause' "—bankruptcy courts are free to " 'consider other factors as they arise, and to use [their] equitable powers to reach an appropriate result in individual cases.' " *In re SGL Carbon Corp.*, 200 F.3d 154, 160 (3d Cir.1999) (quoting H.R.Rep. No. 595, at 406, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6362) (holding that § 1112(b) is not limited to its enumerated examples of "cause"). We therefore decline Piazza's invitation to create unnecessary conflict in the Bankruptcy Code by giving the same statutory language different meanings. *Cf. Hall v. United States*, — U.S. —, 132 S.Ct. 1882, 1891, 182 L.Ed.2d 840 (2012) ("Absent any indication that Congress intended a conflict between two closely related chapters, we decline to create one.").

b. Argument Based on Superfluity

Next, Piazza argues that interpreting "cause" to include bad faith renders superfluous *1266 other provisions of the bankruptcy code that contain an explicit bad faith provision. In particular, Piazza contends that such an interpretation of "cause" in § 707(a) renders superfluous § 707(b), which calls for courts to consider "whether the debtor filed [her] petition in bad faith" when determining whether granting relief would constitute an "abuse" of the bankruptcy laws. See § 707(b)(3) (A).

[16] Piazza's argument is unpersuasive. Although we must, when possible, interpret statutory language so as to give effect to each provision, Chickasaw Nation v. United States, 534 U.S. 84, 94, 122 S.Ct. 528, 535, 151 L.Ed.2d 474 (2001), Piazza's claims of superfluity in this case are overstated. "Redundancies across statutes are not unusual events in drafting," and because "there is no 'positive repugnancy' between" subsection (a) and (b) we "must give effect to both." See Conn. Nat'l Bank v. Germain, 503 U.S. 249, 253, 112 S.Ct. 1146, 1149, 117 L.Ed.2d 391 (1992) (citation omitted); see also Witcher v. Early (In re Witcher), 702 F.3d 619, 621–22 (11th Cir.2012) (holding no superfluity results from considering "debtors' ability to pay their debts under" two different provisions of § 707(b)); Kenneth N. Klee, Bankruptcy and the Supreme Court 20 (2008) (noting that, for purposes of the Bankruptcy Code, "[r]edundancy is not the same as surplusage").

[17] In essence, Piazza argues that our interpretation makes it so that parties in interest will use subsection (a) as the primary device for dismissal under Chapter 7 and ignore

subsection (b), thus rendering it superfluous. But the material differences between § 707(a) and (b) undermine Piazza's argument. First, the provisions cover different types of debt. Section 707(b) governs dismissal of Chapter 7 petitions involving "primarily consumer debts." See § 707(b). Section 707(a) contains no such limitation and on its face governs dismissal of consumer and non-consumer debts. See § 707(a). Therefore, in those cases involving non-consumer or primarily non-consumer debts there will be no overlap with subsection (b). That is certainly true in this case, where Piazza has repeatedly stressed that his debts are "primarily business" related and involve little, if any, consumer debt.

[19] Second, even in consumer debt cases where [18] subsections (a) and (b) concurrently govern dismissal, our interpretation of "for cause" in § 707(a) will not render § 707(b) "wholly superfluous." See Conn. Nat'l Bank, 503 U.S. at 253, 112 S.Ct. at 1149. Unlike subsection (a), subsection (b) allows for a presumption of "abuse"—that is, a presumption that dismissal is warranted—under certain circumstances. See § 707(b)(2)(A)(i); see also Witcher, 702 F.3d at 621 (discussing § 707(b)). Once established, the debtor must produce highly specific evidence to rebut the presumption of abuse. See generally § 707(b)(2)(B). In stark contrast, § 707(a) establishes no such presumption of bad faith or "cause" for dismissal. See § 707(a). Under this Court's precedent, the movant always bears the burden of showing "cause" for dismissal under § 707(a). Simmons, 200 F.3d at 743. In this respect, § 707(b) provides a path for dismissal that is meaningfully different from § 707(a), and one that is not made superfluous by the ordinary meaning of "for cause."

[20] Third, subsection (b) provides remedial options that subsection (a) does not. By its terms, § 707(b) provides not only for dismissal, but also for conversion of a Chapter 7 petition to Chapter 11 or 13 with the debtor's consent. See § 707(b)(1). Subsection (a)'s remedies, however, are limited to dismissal. See § 707(a). Hence, the possibility of conversion to Chapters 11 and 13 provides yet another *1267 reason our interpretation of "for cause" does not "incorporate 'wholesale' the entirety" of § 707(b) into § 707(a).

Finally, Piazza's argument about surplusage leads to an absurdly narrow interpretation of the statute. He claims that if "for cause" in § 707(a) encompasses bad faith, § 707(b) (3) is superfluous as that provision explicitly requires courts to consider "bad faith" when determining whether granting relief would constitute an "abuse" of the bankruptcy laws. *See*

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§ 707(b)(3). On this reading of the statute, however, courts would also render subsection (b) superfluous if they examined "the totality of the circumstances" when determining whether there was "cause" to dismiss under § 707(a). After all, in addition to "bad faith," § 707(b)(3) also requires courts to consider "the totality of the circumstances" when the presumption of abuse does not arise or is rebutted. See id. Thus, Piazza would have this Court construe § 707 such that bankruptcy courts commit reversible error by thoughtfully considering all relevant circumstances when determining whether there is "cause" to dismiss under § 707(a). Such a reading of the statute is absurd and must be rejected. See, e.g., United States v. Brown, 333 U.S. 18, 27, 68 S.Ct. 376, 381, 92 L.Ed. 442 (1948) ("No rule of construction necessitates our acceptance of an interpretation resulting in patently absurd consequences."); United States v. Griffith, 455 F.3d 1339, 1345 (11th Cir.2006) (stressing that this Court will adhere "to the common sense approach ... where we can").

In sum, Piazza is incorrect in asserting that the plain, ordinary meaning of "for cause" in § 707(a) renders § 707(b) "mere surplusage." When read properly, we can "giv[e] effect to both" subsections (a) and (b) without "render[ing] one or the other wholly superfluous." *See Conn. Nat'l Bank*, 503 U.S. at 253, 112 S.Ct. at 1149. Accordingly, we reject the artificial limits Piazza would have us impose on the ordinary meaning of "for cause" in § 707(a).

c. The Specific Controls the General

Similarly, Piazza contends "for cause" does not encompass bad faith, as the general language of § 707(a) is limited by more specific provisions, including 11 U.S.C. §§ 523(a) (19)(B)(i) and 727(a)(2)(A). In relevant part, § 727(a)(2) (A) denies discharge to debtors who, "with intent to hinder, delay, or defraud a creditor" transfer their property "within one year before the date of the filing of the petition." *See* § 727(a)(2)(A). Section 523(a)(19)(B)(i) prohibits debtors from discharging, among other things, any debt that results from any judgment entered in any state judicial proceeding. *See* § 523(a)(19)(B)(i). Piazza essentially argues that, because he qualifies for denial of discharge under these provisions, the bankruptcy court erred in dismissing his case "for cause" under § 707(a).

[21] We reject Piazza's contention that $\S\S 523(a)$ and 727(a) circumscribe the ordinary meaning of "for cause" in $\S 707(a)$. Although specific statutory provisions often "trump" more

general ones, *Nguyen v. United States*, 556 F.3d 1244, 1253 (11th Cir.2009), this presumption "is not an absolute rule," *RadLAX Gateway Hotel, LLC v. Amalgamated Bank,* ——U.S. ——, 132 S.Ct. 2065, 2072, 182 L.Ed.2d 967 (2012). Rather, the "general/specific canon" is simply an "indication of statutory meaning that can be overcome by textual indications that point in the other direction." *Id.*

This case presents just such textual indications. Both the specific terms of the provisions as well as the general design of the Bankruptcy Code show that neither § 523 nor § 727 precludes alternative remedies "to prevent an abuse of process." *1268 See, e.g., 11 U.S.C. § 105(a); Marrama, 549 U.S. at 375–76, 127 S.Ct. at 1112 (noting that even if § 105(a) had never been enacted, bankruptcy courts would nevertheless have authority to dismiss bad faith litigants based on "the inherent power of every federal court to sanction 'abusive litigation practices' " (quoting Roadway Express, Inc. v. Piper, 447 U.S. 752, 765, 100 S.Ct. 2455, 2463, 65 L.Ed.2d 488 (1980))). As the bankruptcy court in this case correctly reasoned, §§ 707(a), 727(a), and 523(a) "provide very different remedies under different circumstances" and are "not directly at odds." Piazza II, 460 B.R. at 325. Whereas § 707(a) prescribes only dismissal and permits refilling under another chapter of the Code, §§ 727(a) and 523 impose the more categorical penalty of denial of discharge. For instance, denial of discharge under § 727(a) (2)–(6) precludes a debtor from discharging other debts under Chapter 7 in subsequent cases filed within one year. See § 727(a)(7). Similarly, pursuant to § 523(a)(10), denial of discharge under § 727(a)(2)–(6) precludes a debtor from discharging any debt that "was or could have been listed or scheduled" in the "prior case." See § 523(a)(10). These differences demonstrate that, even if §§ 727 and 523 are more specific provisions, there is no reason for them to "trump" the more general "for cause" inquiry under § 707(a). See Nguyen, 556 F.3d at 1253.

Also, in the unique context of the Bankruptcy Code, general language intended to prevent abuse often receives its ordinary meaning notwithstanding more specific provisions. See Kestell v. Kestell (In re Kestell), 99 F.3d 146, 148–49 (4th Cir.1996). In Kestell, the Fourth Circuit interpreted § 105(a) as, among other things, "grant[ing] judges the authority to dismiss a bankruptcy petition sua sponte for ... lack of good faith." Id. at 149 (citation omitted). Although other provisions of the Bankruptcy Code addressed good faith more specifically than did the generally-phrased § 105(a), the Fourth Circuit stressed there was "no reason to read

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into" that statute "anything other than its plain meaning." *Id.* (internal quotation marks omitted). Section 105(a) may be an "omnibus provision phrased in ... general terms," the court wrote, but that does not mean more specific provisions divest bankruptcy courts of the powers conferred by § 105(a). See id. at 148 (internal quotation marks omitted).

[22] The same reasoning applies to § 707(a). Cf. id. (noting that "general phrases such as 'for cause' provide broad coverage for unenumerated instances of misuse"). Indeed, not only is Kestell legally correct, see Marrama, 549 U.S. at 367, 127 S.Ct. at 1107 (citing Kestell and reaching a significantly similar conclusion), it also makes good sense. That parties might have two options—one specific, one general—for combating abusive bankruptcy practices is no reason for judges to rewrite either option to be more lenient than the text's ordinary meaning would suppose. Cf. Segarra— Miranda v. Acosta-Rivera (In re Acosta-Rivera), 557 F.3d 8, 13 (1st Cir.2009) (expressing reluctance "to read into" the Bankruptcy Code "by implication a new limit on judicial discretion that would encourage rather than discourage bankruptcy abuse").

d. The Selective Inclusion Presumption

[23] Finally, Piazza argues that, because Congress amended § 707(b) in 2005 to include the phrase "bad faith," it must therefore have intended to exclude bad faith from the meaning of "cause" under § 707(a). See The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. No. 109-8, Title I, § 102(a)(2)(C), 119 Stat. 23. In support of this contention, Piazza relies on the general rule of thumb that, when Congress "includes *1269 particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." Dean v. United States, 556 U.S. 568, 573, 129 S.Ct. 1849, 1854, 173 L.Ed.2d 785 (2009) (internal quotation marks omitted). In Piazza's view, Congress's 2005 amendments to subsection (b) give rise to the inference that anything included in those amendments must, by negative implication, be omitted from subsection (a).

[24] [25] [26] inclusion" presumption is misplaced, as Congress's inclusion of "bad faith" in § 707(b) did not, by implication, transform § 707(a) into a safe harbor for bad faith debtors. As the Supreme Court has instructed, we are not to draw

sweeping inferences "from congressional silence" when such inferences are "contrary to all other textual and contextual evidence of congressional intent." Burns v. United States, 501 U.S. 129, 136, 111 S.Ct. 2182, 2186, 115 L.Ed.2d 123 (1991), modified on other grounds by Irizarry v. United States, 553 U.S. 708, 716, 128 S.Ct. 2198, 2203, 171 L.Ed.2d 28 (2008); see also Ill. Dep't of Pub. Aid v. Schweiker, 707 F.2d 273, 277 (7th Cir.1983) ("Not every silence is pregnant."). The "inference that items not mentioned were excluded by deliberate choice" "has force only when the items expressed are members of an associated group or series." Barnhart v. Peabody Coal Co., 537 U.S. 149, 168, 123 S.Ct. 748, 760, 154 L.Ed.2d 653 (2003) (internal quotation marks omitted). But when it is evident an amended provision "was not modeled after [the earlier one] and is couched in very different terms," the selective inclusion presumption is less persuasive, see Gomez-Perez v. Potter, 553 U.S. 474, 486–87, 128 S.Ct. 1931, 1940, 170 L.Ed.2d 887 (2008), and cannot overcome the ordinary meaning of statutory language, see Field v. Mans, 516 U.S. 59, 75-76, 116 S.Ct. 437, 446, 133 L.Ed.2d 351 (1995) (applying this principle to "common-law language" incorporated in a statute).

Here, the history, text, and structure of § 707(a) and (b) show that the selective inclusion presumption does not apply. First, the provisions were not modeled after one another, nor have they been treated "as part of a package or commonly associated group or series." See Perlin v. Hitachi Capital Am. Corp. (In re Perlin), 497 F.3d 364, 371 (3d Cir.2007) (internal quotation marks omitted) (detailing the legislative history and development of § 707). As originally enacted in 1978, § 707 contained only the "for cause" provision we now recognize as subsection (a). See Bankruptcy Reform Act of 1978, Pub.L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. § 707(a)). Not until 1984, following a consumer credit crisis, did Congress enact subsection (b). See Bankruptcy Amendments and Federal Judgeship Act of 1984 (the 1984 Act), Pub.L. No. 98-353, 98 Stat. 333 (codified as amended at 11 U.S.C. § 707(b)). In enacting subsection (b), Congress was not "narrow[ing]" or "discourag[ing] court review of abuse cases to those involving consumer debt." Stewart v. U.S. Tr. (In re Stewart), 175 F.3d 796, 813 (10th Cir.1999). Rather, although courts dismissed cases "for cause" under the original § 707 based on prepetition bad faith, see, e.g., Piazza's reliance on the "selective Khan, 35 B.R. at 719-20; Sacramento Metro., 28 B.R. at 229-30, they were not doing so as "readily" as Congress would have preferred in the context of consumer debts, see Stewart, 175 F.3d at 813 (noting that § 707(b) "was enacted in response to ... judicial abdication of authority" (internal

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quotation marks omitted)). Therefore, subsection (b) did not limit examination of "abuse" or bad faith to consumer cases; it instead "broaden[ed] and encourag[ed] such review in light of the fact many bankruptcy *1270 courts were not dismissing abusive consumer petitions." *Id.*

Similarly, Congress's addition of a bad-faith provision to subsection (b) in 2005 was intended "to correct perceived abuses of the bankruptcy system," see Milavetz, Gallop & Milavetz, P.A. v. United States, 559 U.S. 229, 130 S.Ct. 1324, 1329, 176 L.Ed.2d 79 (2010), not to limit bankruptcy courts' ability to correct such abuses in non-consumer cases or "plac[e] additional weapons in the hands of abusive debtors," Acosta-Rivera, 557 F.3d at 13 (interpreting 11 U.S.C. § 521). Like subsection (b)'s initial enactment in 1984, the 2005 consumer-specific amendments merely made explicit courts' implicit authority to combat bad faith filings. See Perlin, 497 F.3d at 371 ("[T]he legislative history to the 2005 Act does not indicate that the modifications to section 707(b) imply anything about the dismissal of bankruptcy cases under section 707(a)."); see also H.R.Rep. No. 109–31, at 2 (2005), as reprinted in 2005 U.S.C.C.A.N. 88, 89 ("The purpose of the [2005 amendments] is to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors."). As a result, the codification of "bad faith" in subsection (b) does not imply its removal from § 707(a)—particularly when doing so produces "results strangely at odds with other textual pointers." See Field, 516 U.S. at 75, 116 S.Ct. at 446; cf. Hamilton, 130 S.Ct. at 2475 (rejecting the inference that the incorporation of one provision signaled Congress's intent "to eliminate, sub silentio, the discretion that courts previously exercised").

The text and structure of subsection (a) and (b) also make clear they are "couched in very different terms." See Gomez–Perez, 553 U.S. at 488, 128 S.Ct. at 1941. The relatively brief § 707(a) is phrased in general language—i.e., "for cause"—while § 707(b) is prolix and detailed. Subsection (b), as discussed, establishes a fairly sophisticated computation scheme for determining when a movant has established certain presumptions and when a debtor has successfully rebutted those presumptions. See § 707(b)(2)–(3). Subsection (a), by contrast, involves no such mathematical analysis. Its mechanism for determining when dismissal is warranted turns on the simple, general words "for cause"—a phrase left undefined in the Code "so as to afford flexibility to the bankruptcy courts." Little Creek, 779 F.2d at 1072.

Thus, this is not a case in which "an omission bespeaks a negative implication." See Chevron U.S.A. Inc. v. Echazabal, 536 U.S. 73, 81, 122 S.Ct. 2045, 2050, 153 L.Ed.2d 82 (2002). The vast, material differences between § 707(a) and (b) cover far more than a single, key term that is included in one provision but omitted from the other. Cf. Myers v. TooJay's Mgmt. Corp., 640 F.3d 1278, 1284 & n. 5 (11th Cir.2011) (applying the selective inclusion presumption because the only relevant distinction between two provisions of the Bankruptcy Code was the "conspicuous absence" of a single phrase). Contrary to Piazza's claims, the more reasonable inference to be drawn from Congress's decision not to amend § 707(a) is that bad faith was already clearly encompassed within the ordinary meaning of "for cause" dismissal. Cf. Perlin, 497 F.3d at 371 ("There is no indication that Congress intended [the 2005 amendments] to restrict a bankruptcy court's discretion in deciding motions to dismiss under section 707(a)."). In other words, § 707(a) was left undisturbed because "nothing more need[ed] [to] be said in order to effectuate the relevant legislative objective." See Burns, 501 U.S. at 136, 111 S.Ct. at 2186.

* * *

Piazza has offered no persuasive reason to depart from the settled, ordinary meaning *1271 of "for cause" in § 707(a). As relevant sources indicate, the ordinary meaning of "for cause" is adequate or sufficient reason. Prepetition bad faith unquestionably constitutes adequate or sufficient reason to dismiss a Chapter 7 petition. Hence, the bankruptcy court did not err in holding that the "for cause" language of § 707(a) permits involuntary dismissal upon a finding that the debtor's petition was filed in bad faith.

B. Bankruptcy Court's Dismissal of Piazza's Petition for Bad Faith

[27] [28] Having concluded that prepetition bad faith constitutes "cause" for dismissal under § 707(a), we must next determine whether the bankruptcy court abused its discretion in dismissing Piazza's case based on the court's finding of prepetition bad faith. See Bal Harbour Club, Inc. v. AVA Dev., Inc. (In re Bal Harbour Club, Inc.), 316 F.3d 1192, 1194 (11th Cir.2003) (indicating that dismissals "for cause" under § 1112(b) are reviewed for abuse of discretion). An abuse of discretion occurs when a court applies the wrong principle of law or makes clearly erroneous findings of fact. United States v. Frazier, 387 F.3d 1244, 1259 (11th Cir.2004) (en banc). The legal standard by which the court finds bad faith is a question of law reviewed de novo, see In re Love, 957 F.2d 1350, 1354

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(7th Cir.1992), while the finding of bad faith itself is a factual determination "that we review only for clear error," *DeLauro v. Porto (In re Porto)*, 645 F.3d 1294, 1304 (11th Cir.2011).

1. Legal Standard for Determining Bad Faith

As noted, the bankruptcy court found bad faith based on a multi-part totality-of-the-circumstances standard. *See Piazza I*, 451 B.R. at 614–15 (citing *Baird*, 456 B.R. at 116–17). Piazza argues the bankruptcy court "appl[ied] nothing more than a 'sniff test' " in finding bad faith. Although he does not articulate what the test should be, Piazza contends it should be something more than a bankruptcy judge deciding who deserves to be in bankruptcy court "pursuant to his or her own standards."

[29] Piazza's arguments are without merit and his characterization of the bankruptcy court's decision in this case is unfounded. Bad faith does not lend itself to a strict formula. See Natural Land Corp. v. Baker Farms, Inc. (In re Natural Land Corp.), 825 F.2d 296, 298 (11th Cir.1987) (noting "there is no particular test for determining whether a debtor has filed ... in good faith"); see also Gen. Trading Inc. v. Yale Materials Handling Corp., 119 F.3d 1485, 1501 (11th Cir.1997) (observing "'bad faith' is not defined in the bankruptcy code," and "there is no legislative history addressing the intended meaning" of the term). It is instead a fact-intensive judgment that is "subject to judicial discretion under the circumstances of each case." Albany Partners, Ltd. v. Westbrook (In re Albany Partners, Ltd.), 749 F.2d 670, 674 (11th Cir.1984); cf. Tamecki, 229 F.3d at 207 ("[T]he decision to dismiss a petition for lack of good faith rests within the sound discretion of the bankruptcy court.").

[30] [32] [33] [31] discretionary nature, a totality-of-the-circumstances approach is the correct legal standard for determining bad faith under § 707(a). The totality-of-the-circumstances inquiry looks for "atypical" conduct, see Marrama, 549 U.S. at 375 n. 11, 127 S.Ct. at 1111 n. 11, that falls short of the "honest and forthright invocation of the [Bankruptcy] Code's protections," Kestell, 99 F.3d at 149.7 In making that determination, bankruptcy courts must, as *1272 they so often do, "'sift the circumstances surrounding [a] claim to see that injustice or unfairness is not done." "See Connell v. Coastal Cable T.V., Inc. (In re Coastal Cable T.V., Inc.), 709 F.2d 762, 764 (1st Cir.1983) (quoting *Pepper v. Litton*, 308 U.S. 295, 304–05, 307-08, 60 S.Ct. 238, 244, 245-46, 84 L.Ed. 281 (1939)). Under this inquiry, bad faith is ultimately "evidenced by the debtor's deliberate acts or omissions that constitute a misuse or abuse of the provisions, purpose, or spirit of the Bankruptcy Code." *McDow*, 295 B.R. at 74; *see also Tamecki*, 229 F.3d at 207 (holding that bad faith turns on "whether the petitioner has abused the provisions, purpose, or spirit of bankruptcy law"—a determination which can be made only on a case-by-case basis); *Black's Law Dictionary* 159 (9th ed. 2009) (defining a "bad-faith filing" as one "that is inconsistent with the purposes of the Bankruptcy Code or is an abuse of the bankruptcy system").

Among other considerations that might indicate bad faith are a debtor's "intent to abuse the judicial process," Albany Partners, 749 F.2d at 674, a debtor's intentional efforts "to delay or frustrate" legitimate creditors, id., a debtor "deliberately rack[ing] up debts he has no ability to repay and then seek[ing] to shield himself from creditors through bankruptcy," Padilla, 222 F.3d at 1194-95 (Rymer, J. dissenting), a debtor having "noneconomic motives," including "to frustrate [a] divorce court decree" or force an ex-spouse into bankruptcy, Huckfeldt, 39 F.3d at 832, a debtor "using bankruptcy as a refuge from another court's jurisdiction," id., a debtor making "every effort to avoid payment of an obligation" despite being "capable of at least partial repayment," Zick, 931 F.2d at 1127 n. 3 (internal quotation marks omitted), a debtor having primarily a "single creditor," id. at 1128, a debtor's "failure to make significant lifestyle adjustments or efforts to repay," id., and a disproportionate debt-to-income ratio in the absence of a "marked calamity or sudden loss of income," Tamecki, 229 F.3d at 207. These considerations, however, are "not exhaustive." See Natural Land Corp., 825 F.2d at 298.

[35] [36] Contrary to Piazza's assertions, this does not amount simply to a "sniff test." As with the determination [34] In light of its inherently bad faith in other contexts, "a conclusory finding ... is not sufficient to withstand appellate review." See Porto, 645 F.3d at 1305 (reviewing a bankruptcy court's sanctioning of a litigant for bad faith). The bankruptcy court must articulate reasoned bases and make adequate factual findings to support its determination of bad faith under § 707(a). See Zick, 931 F.2d at 1127-28 (reasoning that the grounds for a determination of bad faith "should be set out in the bankruptcy court's decision"). After all, even though we review a finding of "bad faith" only for clear error, see Porto, 645 F.3d at 1304, "bald assertions provide no meaningful basis for this court to review the ultimate finding of 'bad faith,' " Rothenberg v. Sec. Mgmt. Co., 736 F.2d 1470, 1472-73 (11th Cir.1984) (remanding a case for further factual findings regarding attorney sanctions).

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[38] Here, the bankruptcy judge relied on factors [37] from In re Baird when determining whether the totality of the circumstances revealed bad faith. See Piazza I, 451 B.R. at 614-15. Although we do not adopt the *Baird* factors, the bankruptcy court did not commit reversible error in its totality-of-the-circumstances analysis. Rather, similar to the inquiry we endorse, the bankruptcy court examined the relevant facts of the case to determine Piazza's "intentions" and whether he was "an honest but unfortunate debtor entitled to a fresh start." See id. at 615. The court then articulated reasoned bases for its finding of bad faith and explained that finding in terms of indisputable record evidence. See id. at 616–17. The bankruptcy court, therefore, did not apply an erroneous legal standard in dismissing Piazza's case for bad faith.8

8 We also reject Piazza's claim that "the 'notice and a hearing' requirement was not fulfilled" in this case. In relevant part, § 102(1)(A) of the Bankruptcy Code defines "notice and a hearing" to "mean []after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances." 11 U.S.C. § 102(1) (A) (emphases added). In this case, these criteria were satisfied. Piazza was clearly on notice of Nueterra's motion to dismiss for bad faith. Also, when asked by the bankruptcy court whether an evidentiary hearing was necessary, Piazza's counsel confidently declared "[n]ot at all, Your Honor." Piazza cannot now claim on appeal he was somehow denied "minimal procedural due process" in the bankruptcy court.

*1273 2. Factual Determination of Piazza's Bad Faith

[39] [40] We now decide whether, under the totality of the circumstances, the bankruptcy court's finding of bad faith in this case was clearly erroneous. See Frazier, 387 F.3d at 1259. A factual finding is clearly erroneous only when this Court, after reviewing all of the evidence, is left with "the definite and firm conviction" that a mistake has been committed. Senior Transeastern Lenders v. Official Comm. of Unsecured Creditors (In re TOUSA, Inc.), 680 F.3d 1298, 1310 (11th Cir.2012). Such a conviction arises only when there has been "a manifest disregard of right and reason." Godfrey v. Powell, 159 F.2d 330, 332 (5th Cir.1947).

In *Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir.1981) (en banc), this Court adopted as binding precedent all decisions of the former Fifth Circuit handed

down prior to the close of business on September 30, 1981

[41] Piazza argues the bankruptcy court's finding of bad faith meets this exacting standard because it is not only unsupported by the record, but is also contrary to the only evidence in the record. Piazza's contentions are meritless and sharply contradicted by his own admissions before the bankruptcy court. First, the court did not clearly err in finding Piazza filed bankruptcy "to avoid" paying a "large single debt" arising from a state-court judgment he evaded for more than two years. *Piazza I*, 451 B.R. at 616. Piazza admitted in his Schedule F and in his motion to the bankruptcy court that more than half of his total debt was a large, single debt owed to one unsecured creditor—Nueterra. Piazza also admitted not paying Nueterra's state-court judgment for over two years, and that it was "the motivating factor" in filing bankruptcy when he did.

Second, the court did not clearly err in finding that despite his debts to Nueterra and others, Piazza continued "paying debts of insiders" and transferred thousands of dollars every month to his wife. *Id.* at 616. Piazza admitted in his Schedules F and J, in his deposition testimony, ¹⁰ and in his motion to the bankruptcy court, that he continued paying his great aunt's mortgage despite the interest-bearing, \$161,383 state-court judgment he owed. Also, while Piazza now contends there is "no evidence" he transferred assets or money to his wife, Piazza admitted in his deposition he had *1274 been transferring \$4,000 "and change" to his wife every month for "a little over five years." Piazza's motion to the bankruptcy court also admitted that turning over "most of his paycheck" to his wife was a consistent "practice" "[s]ince the beginning of the marriage."

10 Piazza argues his "deposition testimony was not in the record below," and therefore his sworn admissions "should not be in the record herein." Piazza is blatantly wrong on both points. Pertinent evidence from the deposition was presented to the bankruptcy court in Piazza's motion to the court and by Nueterra's counsel at oral argument. Also, the entire deposition transcript was included in Nueterra's filings with the district court. Moreover, even if this were not the case, Piazza's sworn deposition testimony would not categorically be excluded from consideration. See, e.g., Schwartz v. Millon Air, Inc., 341 F.3d 1220, 1225 n. 4 (11th Cir.2003) (stressing this Court's equitable authority to supplement the record when "in the interests of justice"); CSX Transp., Inc. v. City of Garden City, 235 F.3d 1325, 1330 (11th Cir.2000) (reaffirming this Court's equitable

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power to supplement the record when evidence "would establish beyond any doubt the proper resolution of the pending issues").

Third, the court did not clearly err in finding Piazza failed to repay his creditors or "make life-style adjustments" despite his debts. Id. at 616-17. Piazza admitted in his motion to the bankruptcy court that he had paid Nueterra nothing prior to filing for bankruptcy. Piazza admitted that, despite his debts, he cosigned on his sister's car loan, leased a new luxury vehicle for himself in 2010, and every month transferred thousands of dollars to his wife while she, in turn, spent \$2,000 per month on credit cards and invested \$2,000 per month in her 401(k). Piazza contends his activities and failure to change his lifestyle do not violate the Bankruptcy Code, and therefore should not factor into the bad faith calculus. However, even assuming Piazza's financial activities were not expressly prohibited by the Bankruptcy Code, his conduct nonetheless supports the bankruptcy court's finding that he refused to make life-style adjustments.

[42] Fourth, the court did not clearly err in finding Piazza failed to pay his creditors despite having "sufficient resources" to "repay at least a portion of his debts." *Id.* at 617. Piazza admitted in his Amended Schedule I that he and his wife's joint monthly income exceeds \$10,000. This means that between entry of the state-court judgment in favor of Nueterra in January 2008, and Piazza's bankruptcy filing in October 2010, Piazza and his wife collectively made more than \$300,000. Moreover, Piazza admitted in his motion to the bankruptcy court that his wife, who makes less than him, earns a "substantial income." By parity of reasoning, Piazza himself earns even *more* than a "substantial income" and the Piazzas' joint household income comprises at least two "substantial income[s]."

Although bankruptcy courts may not rely *solely* upon a debtor's ability to pay to the exclusion of all other considerations, a debtor's resources is one relevant indicator, among many, of bad faith or "cause" to dismiss. *See, e.g., Perlin,* 497 F.3d at 374 (collecting cases). In this case, the bankruptcy court did not rely exclusively, or even primarily, on Piazza's ability to repay his debts. Much to the contrary, the court considered Piazza's admittedly "substantial income" alongside a litany of other permissible indicia of bad faith. *See Piazza I,* 451 B.R. at 614–17.

Under the totality of the circumstances, the bankruptcy court did not clearly err in finding Piazza filed his Chapter 7 petition in bad faith. Indeed, Piazza's own admissions show the bankruptcy court's factual finding of bad faith is anything but "a manifest disregard of right and reason." *Godfrey*, 159 F.2d at 332. Accordingly, the bankruptcy court did not abuse its discretion in dismissing Piazza's Chapter 7 petition on a finding of bad faith.

III. CONCLUSION

For the foregoing reasons, the order of the bankruptcy court dismissing Piazza's Chapter 7 bankruptcy petition is **AFFIRMED.**

All Citations

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In re RS Air, LLC, 638 B.R. 403 (2022)

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638 B.R. 403

United States Bankruptcy Appellate
Panel of the Ninth Circuit.

IN RE: RS AIR, LLC, Debtor.

NetJets Aviation, Inc.; NetJets Sales,

Inc.; NetJets Services, Inc., Appellants,

v.

RS Air, LLC, Appellee.

BAP No. NC-21-1227-BGT | | Bk. No. 20-51604

Argued and Submitted on January 19, 2022 at Pasadena, California

APRIL 26, 2022

Synopsis

Background: Creditor appealed from orders of the United States Bankruptcy Court for the Northern District of California, M. Elaine Hammond, J., denying its objection to Chapter 11 debtor's Subchapter V election and later ruling upholding the eligibility decision in confirming the plan.

Holdings: The Bankruptcy Appellate Panel, Brand, J., held that:

- [1] debtor was not required to be maintaining its core or historical operations on petition date to be eligible to proceed under Subchapter V of Chapter 11;
- [2] profit motive was not required for debtor to be eligible to proceed under Subchapter V of Chapter 11;
- [3] debtor, and not objecting party, had burden to prove eligibility to proceed under Subchapter V of Chapter 11;
- [4] Bankruptcy Court's error in allocating burden to objecting creditor as to debtor's eligibility to proceed under Subchapter V of Chapter 11 was harmless, because debtor met its burden; and

[5] any error by Bankruptcy Court made in not considering exceptions to law of the case doctrine was harmless.

Affirmed.

West Headnotes (16)

[1] Bankruptcy • Interlocutory orders; collateral order doctrine

Bankruptcy Court's interlocutory order denying creditor's objection to Chapter 11 debtor's Subchapter V election merged into the final confirmation order, for purposes of appeal.

[2] Bankruptcy Conclusions of law; de novo review

Bankruptcy Particular cases and issues

Question of whether a particular activity constitutes "commercial or business activities" for purposes of debtor's eligibility to proceed under Subchapter V of Chapter 11 is a legal question the Bankruptcy Appellate Panel (BAP) reviews de novo, and the bankruptcy court's determination whether debtor engaged in that particular activity is a factual question reviewed for clear error. 11 U.S.C.A. § 1182(1)(A).

2 Cases that cite this headnote

[3] Bankruptcy 🤛 Clear error

Bankruptcy court's factual findings are "clearly erroneous" if they are illogical, implausible, or without support in the record.

1 Case that cites this headnote

[4] Bankruptcy Conclusions of law; de novo review

Whether the bankruptcy court identified and applied the correct burden of proof is a question of law the Bankruptcy Appellate Panel (BAP) reviews de novo.

In re RS Air, LLC, 638 B.R. 403 (2022)

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1 Case that cites this headnote

[5] Bankruptcy Discretion

Bankruptcy Appellate Panel (BAP) reviews bankruptcy court's decision whether to apply law of the case doctrine for abuse of discretion.

1 Case that cites this headnote

[6] Bankruptcy 🕪 Discretion

Bankruptcy court abuses its discretion if it applies wrong legal standard, or misapplies correct legal standard, or makes factual findings that are illogical, implausible, or without support in inferences that may be drawn from facts in record.

1 Case that cites this headnote

[7] Bankruptcy Peorganization cases

Generally, a debtor is eligible to elect Subchapter V of Chapter 11 if the debtor: (1) is a "person"; (2) is engaged in commercial or business activities; (3) does not have aggregate debts in excess of the debt limit on the petition date; and (4) at least 50 percent of the debtor's debts arose from its commercial or business activities. 11 U.S.C.A. § 1182(1)(A).

6 Cases that cite this headnote

[8] Bankruptcy — Corporations

A limited liability company (LLC) is a "person," for purposes of determining debtor's eligibility to proceed under Subchapter V of Chapter 11. 11 U.S.C.A. § 1182(1)(A).

3 Cases that cite this headnote

[9] Bankruptcy Pankruptcy Reorganization cases

Debtor need not be maintaining its core or historical operations on petition date to be eligible to proceed under Subchapter V of Chapter 11, but it must be presently engaged in some type of commercial or business activities. 11 U.S.C.A. § 1182(1)(A).

5 Cases that cite this headnote

[10] Bankruptcy Peorganization cases

Profit motive was not required for debtor to be eligible to proceed under Subchapter V of Chapter 11. 11 U.S.C.A. § 1182(1)(A).

[11] Bankruptcy 🔛 Evidence and fact questions

Debtor, and not objecting party, had burden to prove eligibility to proceed under Subchapter V of Chapter 11. 11 U.S.C.A. § 1182(1)(A).

3 Cases that cite this headnote

[12] Bankruptcy Parmless error

Bankruptcy Court's error in allocating burden to objecting creditor as to debtor's eligibility to proceed under Subchapter V of Chapter 11 was harmless, because debtor met its burden by demonstrating that it was engaged in commercial or business activities on the petition date, which was the only criterion challenged by creditor on eligibility. 11 U.S.C.A. § 1182(1)(A).

7 Cases that cite this headnote

[13] Courts Previous Decisions in Same Case as Law of the Case

Doctrine of "law of the case" provides that court is generally precluded from reconsidering issue that has already been decided by same court, or higher court in identical case.

[14] Courts Previous Decisions in Same Case as Law of the Case

To apply doctrine of law of the case, issue in question must have been decided either expressly or by necessary implication in previous disposition.

[15] Courts Previous Decisions in Same Case as Law of the Case

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Federal Courts ← Effect of Decision in Lower Court

Court may revisit previously resolved question when: first decision was clearly erroneous; intervening change in law has occurred; evidence on remand is substantially different; other changed circumstances exist; or manifest injustice would otherwise result.

[16] Bankruptcy Parmless error

Any error by Bankruptcy Court made in not considering exceptions to law of the case doctrine in denying creditor's objection to Chapter 11 debtor's Subchapter V election and later ruling upholding the eligibility decision in confirming the plan was harmless, because no new evidence was presented at the final confirmation trial that the court should have considered or that would have changed the outcome.

*405 Appeal from the United States Bankruptcy Court for the Northern District of California, M. Elaine Hammond, Bankruptcy Judge, Presiding

Attorneys and Law Firms

Kelly Singer of Squire Patton Boggs (US) LLP argued for appellants;

Jennifer C. Hayes of Finestone Hayes LLP argued for appellee.

Before: BRAND, GAN, and TAYLOR, Bankruptcy Judges.

OPINION

BRAND, Bankruptcy Judge:

INTRODUCTION

Appellants NetJets Aviation, Inc., NetJets Sales, Inc., and NetJets Services, Inc. (collectively, "NetJets") appeal an order confirming the chapter 11¹ plan of debtor RS Air, LLC ("RS

Air"). Specifically, NetJets appeals the bankruptcy court's prior order denying its objection to RS Air's subchapter V election, and the court's later ruling upholding the eligibility decision in confirming the plan.

Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532.

NetJets argues that the bankruptcy court erred in determining that RS Air was eligible for subchapter V relief. According to NetJets, since RS Air had no profit motive, it was not "engaged in commercial or business activities" on the petition date pursuant to § 1182(1)(A). NetJets argues that the bankruptcy court further erred by allocating the burden of proof to NetJets to establish that RS Air was not eligible for subchapter V. Finally, NetJets argues that the bankruptcy court erred in ruling that the law of the case doctrine precluded the court from reconsidering RS Air's eligibility for subchapter V when new evidence at the final confirmation trial demonstrated that it was ineligible.

As relevant here, § 1182(1)(A) provides that the term "debtor" "means a person engaged in commercial or business activities ... that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than \$7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor." NetJets does not challenge RS Air's eligibility based on debt limits.

We hold that a profit motive is not required to satisfy § 1182(1)(A). We further hold that the burden is on the debtor to prove subchapter V eligibility. Although the bankruptcy court ruled otherwise on that issue, such error was harmless, because *406 the record established that RS Air met its burden of establishing its eligibility to proceed under subchapter V. Finally, we conclude that any error the bankruptcy court made regarding its law of the case ruling was harmless, because no new evidence was presented at the final confirmation trial that the court should have considered or that would have changed the outcome. Accordingly, we AFFIRM.

FACTS

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RS Air, a Delaware LLC doing business in California, was formed in 2001 by its sole member and manager, Stephen Perlman, for the purpose of using and providing aircraft transportation services, acquiring and selling interests in aircraft, and providing depreciation tax benefits to Perlman. From 2001 to 2017, RS Air's principal source of revenue from business operations was from providing flight services for Perlman and affiliated third parties and flying fragile technology prototypes to prevent damage from baggage handling on commercial flights. RS Air also obtained revenue from acquiring and selling fractional interests in aircraft.

Beginning in 2001, RS Air entered into a series of agreements to purchase or lease from NetJets fractional interests in private jets. NetJets is a private business jet charter company that sells fractional jet interests, charter jet flight time, and aircraft management services. NetJets actively marketed depreciation tax benefits as a key benefit to fractional jet ownership.

The parties had a good business relationship until July 2017, when one of the jets fractionally owned by RS Air was involved in a non-injury runway crash, which RS Air contends NetJets failed to disclose and was caused by a NetJets pilot. RS Air ceased doing business with NetJets after the accident and was still not engaged in its normal flight operations when it filed for bankruptcy in November 2020. RS Air attributed its lack of operations to NetJets not allowing RS Air to use or sell any jets after the accident and the parties' falling out. Ultimately, the parties ended up in litigation in Ohio, with NetJets filing suit against RS Air for breach of contract and RS Air asserting counterclaims against NetJets for breach of contract and fraud.

B. The bankruptcy case and litigation over subchapter V eligibility

Just before trial was to begin in Ohio, RS Air filed a chapter 11 bankruptcy case and elected to proceed under subchapter V. NetJets is RS Air's largest, non-insider creditor and holds approximately 98% of the total non-insider debt.

1. Objection to subchapter V designation

NetJets objected to RS Air's election as a subchapter V debtor, arguing that RS Air was not eligible for subchapter V because it was not currently "engaged in commercial or business activities" pursuant to § 1182(1)(A). NetJets argued that RS Air had no flight operations since at least 2017, no revenue or income since as early as 2012, and no employees. In fact, argued NetJets, RS Air had never been a revenue-generating

business, and its sole purpose was to serve as the intermediary through which Perlman acquired interests in and paid for the availability and use of private jets. NetJets argued that it was RS Air's burden to establish eligibility for subchapter V.

In opposition, RS Air argued that ongoing operations, employees, or historical profitability were not required for subchapter V eligibility. RS Air argued that it was currently engaged in business activities by (1) litigating with NetJets, (2) negotiating with NetJets to sell its fractional *407 jet interests back to NetJets, (3) paying its aircraft registry fees, (4) remaining in good standing as a Delaware LLC, and (5) keeping its tax obligations current with the state of California and the federal government. RS Air also intended to resume normal flights operations with a different partner once able. RS Air argued that NetJets, as the movant, bore the burden of establishing that RS Air was not eligible for subchapter V.

The bankruptcy court overruled NetJets' objection to RS Air's subchapter V election ("Subchapter V Order"). First, it determined that NetJets, as the party challenging eligibility, had the burden to establish that RS Air was not eligible for subchapter V. Second, it found that RS Air was engaged in commercial or business activities on the petition date because RS Air: (1) transformed its business from flight services to investigation into and litigation with NetJets (its primary contractual party); (2) intended to resume fractional jet ownership with a different partner; (3) paid its aircraft registry fees; (4) remained in good standing as a Delaware LLC; and (5) filed its tax returns and paid taxes as required. The court rejected NetJets' argument that employees are required for eligibility, observing that many small businesses have no employees. Therefore, because NetJets did not meet its burden to establish that RS Air failed to satisfy the eligibility requirements of § 1182, RS Air would proceed as a subchapter V debtor.

2. RS Air's plan of reorganization

At an earlier plan confirmation hearing, Perlman testified that, while some income is generated from providing flights to him or his related entities, RS Air would have no projected disposable income within the next five years, if ever. Instead, the primary financial benefit obtained is a tax deduction for aircraft depreciation that flows through Perlman. As a result, he would pay all administrative expenses and contribute new value of \$50,000 (later increased to \$100,000), which was more than the expected disposable income of \$0.

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At the final plan confirmation hearing, RS Air's financial expert testified that the net present value of RS Air's projected disposable income was \$8,200. Because RS Air's value in a traditional disposable income analysis was projected to be a large negative number in the three- to five-year period postconfirmation, the financial expert created an alternative model to capture nontraditional kinds of value (e.g., tax benefits and aircraft flight services) that would not be included in a traditional analysis. The expert's alternative model recognized that RS Air was set up primarily to create value as a tax benefit from owning a fractional aircraft share and providing aircraft flight services, not to create value from profit on income.

In opposing confirmation, NetJets again argued that RS Air was not eligible for subchapter V, and therefore the Plan did not meet the good faith requirement of § 1129(a)(3). NetJets argued that RS Air was not a business with income, the expert's financial projections improperly included indirect items of value such as the depreciation tax benefit, and the expert's financial projections were based on non-GAAP and never-before-seen methodologies. NetJets contended that the real purpose of RS Air's subchapter V bankruptcy was to sustain a facade business with no operations or income to protect Perlman and affiliates and provide him with valuable tax benefits.

In confirming RS Air's third amended plan of reorganization (the "Confirmation Order"), the bankruptcy court found that the disposable income projections of Perlman and RS Air's financial expert were *408 consistent with NetJets' argument that RS Air was not a business with income, but that whether RS Air generated income was not determinative for confirmation. The court decided that the law of the case doctrine precluded revisiting the issue of RS Air's subchapter V designation. However, the court noted that developing case law, which interpreted broadly the types of commercial or business activities that can satisfy § 1182(1)(A), supported its earlier decision that RS Air was engaged in commercial or business activities on the petition date. NetJets timely appealed the Confirmation Order, which included the prior Subchapter V Order. A motions panel granted NetJets' request for stay of the Confirmation Order pending appeal.

JURISDICTION

- [1] The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334 and 157(b)(2)(L). We have jurisdiction under 28 U.S.C. § 158.³
- The interlocutory Subchapter V Order merged into the final Confirmation Order. SeeUnited States v. Real Prop. Located at 475 Martin Lane, 545 F.3d 1134, 1141 (9th Cir. 2008) (under merger rule, interlocutory orders entered prior to the judgment merge into the judgment and may be challenged on appeal).

ISSUES

- 1. Did the bankruptcy court err in determining that RS Air was "engaged in commercial or business activities" on the petition date?
- 2. Did the bankruptcy court err by allocating the burden to NetJets to prove that RS Air was not eligible for subchapter V?
- 3. Did the bankruptcy court abuse its discretion in determining that the law of the case doctrine precluded its review of the Subchapter V Order?

STANDARDS OF REVIEW

- [2] [3] The question of whether a particular activity constitutes "commercial or business activities" under § 1182(1)(A) is a legal question we review de novo, and the bankruptcy court's determination whether the debtor engaged in that particular activity is a factual question we review for clear error. SeeInt'l Ass'n of Firefighters, Local 1186 v. City of Vallejo (In re City of Vallejo), 408 B.R. 280, 288-89 (9th Cir. BAP 2009) (we review questions of law and statutory interpretation of the Code de novo and the bankruptcy court's factual findings for clear error) (chapter 9 eligibility); see alsoWatford v. Fed. Land Bank of Columbia, 898 F.2d 1525, 1527 (11th Cir. 1990) (applying these standards of review to chapter 12 eligibility). Factual findings are clearly erroneous if they are illogical, implausible, or without support in the record. Retz v. Samson (In re Retz), 606 F.3d 1189, 1196 (9th Cir. 2010).
- [4] Whether the bankruptcy court identified and applied the correct burden of proof is a question of law we review de novo. *Boruff v. Cook Inlet Energy LLC (In re Cook Inlet Energy LLC)*, 583 B.R. 494, 500 (9th Cir. BAP 2018).

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[5] [6] We review the bankruptcy court's decision whether 1182(1)(A). The Bankruptcy Code does not define the phrase to apply the law of the case doctrine for an abuse of discretion. SeeUnited States v. Lummi Indian Tribe, 235 F.3d 443, 452 (9th Cir. 2000). A bankruptcy court abuses its discretion if it applies the wrong legal standard, or misapplies the correct legal standard, or makes factual findings that are illogical, implausible, or without support in inferences that may be drawn from the facts in the record. See United States v. Hinkson, 585 F.3d 1247, 1262 (9th Cir. 2009) (en banc).

*409 DISCUSSION

A. The bankruptcy court did not err in determining that RS Air was "engaged in commercial or business activities" on the petition date.

[7] [8] Under the Small Business Reorganization Act of 2019, commonly referred to as "subchapter V," Congress authorized eligible persons to avail themselves of streamlined chapter 11 bankruptcy relief designed to help small businesses. 4 Generally, a debtor is eligible to elect subchapter V if the debtor: (1) is a "person;" (2) is "engaged in commercial or business activities;" (3) does not have aggregate debts in excess of the debt limit on the petition date; and (4) at least 50 percent of the debtor's debts arose from its commercial or business activities. § 1182(1)(A).

The SBRA became effective on February 19, 2020. See11 U.S.C. §§ 1181, et seq. Small Business Reorganization Act of 2019 (HR 3311), Pub. L. No. 116-54, 133 Stat. 1079 (Aug. 23, 2019). The statute as originally enacted defined the debtor under § 101(51D), in the same way as a small business debtor who does not elect to proceed under subchapter V. As part of the Coronavirus, Aid, Relief, and Economic Security Act (HR 748), Pub. L. No. 116-136, 134 Stat. 281, 116th Cong. 2d Sess. (Mar. 27, 2020), the definition was changed to temporarily increase the debt limit to \$7,500,000 for debtors who elected subchapter V and included a sunset of one year. The one-year sunset for this temporary amendment was extended to March 27, 2022, by the COVID-19 Bankruptcy Relief Extension Act of 2021, Pub. L. No. 117-5 (Mar. 27, 2021). In this case, § 1182(1)(A) applies for the definition of a subchapter V debtor.

An LLC is a "person." Gilliam v. Speier (In re KRSM Props., LLC), 318 B.R. 712, 717 (9th Cir. BAP 2004).

The only question here is whether RS Air was "engaged in commercial or business activities" within the meaning of §

and case law is sparse. With one exception, no appellate court has weighed in on the subject. The trial courts that have reviewed it are divided as to its meaning.

A majority of courts have held that a debtor need not be "actively operating" on the petition date, but must be "presently" engaged in commercial or business activities on the petition date to satisfy § 1182(1)(A). SeeNat'l Loan Invs., L.P. v. Rickerson (In re Rickerson), 636 B.R. 416, 424-25 (Bankr. W.D. Pa. 2021); Lyons v. Family Friendly Contracting LLC (In re Family Friendly Contracting LLC), No. 21-14213-TJC, 2021 WL 5540887, at *3 (Bankr. D. Md. Oct. 26, 2021); In re McCune, 635 B.R. 409, 418-22 (Bankr. D.N.M. 2021); In re Vertical Mac Constr., LLC, No. 6:21bk-01520-LVV, 2021 WL 3668037, at *2 (Bankr. M.D. Fla. July 23, 2021) ("operations" insinuates a fully functioning business but "activities" includes acts that are business in nature but fall short of an actual operating business); In re Port Arthur Steam Energy, L.P., 629 B.R. 233, 236-37 (Bankr. S.D. Tex. 2021); In re Blue, 630 B.R. 179, 189-90 (Bankr. M.D.N.C. 2021); In re Offer Space, LLC, 629 B.R. 299, 305-07 (Bankr. D. Utah 2021); In re Ikalowych, 629 B.R. 261, 283-84 (Bankr. D. Colo. 2021); In re Johnson, No. 19-42063-ELM, 2021 WL 825156, at *6-8 (Bankr. N.D. Tex. Mar. 1, 2021); In re Thurmon, 625 B.R. 417, 422-23 (Bankr. W.D. Mo. 2020). Two courts have held that the debtor need not have been engaged in any commercial or business activities on the petition date to qualify for subchapter V, as long as the debtor was engaged in such activities at some point in the past. SeeIn re Blanchard, No. 19-12440, 2020 WL 4032411, at *2 (Bankr. E.D. La. July 16, 2020) (finding that "engaged in" has no temporal limit); *410 In re Wright, No. 20-01035-HB, 2020 WL 2193240, at *3 (Bankr. D.S.C. Apr. 27, 2020) (debtor need not be "currently" engaged in commercial or business activities on the petition date). Notably, those courts were two of the first to consider the issue.

[9] We agree with the majority, that the term "engaged in" is inherently contemporary in focus and not retrospective. Thus, a debtor need not be maintaining its core or historical operations on the petition date, but it must be "presently" engaged in some type of commercial or business activities to satisfy § 1182(1)(A).

The next question is, when a debtor is no longer operational, what types of "activities" satisfy the requirement that the debtor be engaged in commercial or business activities. In using the common meanings of the terms and other statutory

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construction methods, courts generally have held that the scope of commercial or business activities is very broad and apply a "totality of the circumstances" standard. SeeIn re Rickerson, 636 B.R. at 425-26 (reasoning that "winding down" is a business activity and could be enough for § 1182(1)(A) but not deciding the issue because debtor's entities had been inactive for years prepetition, with no assets, no employees, no accounts, and the debtor had no intent to reactivate any of the entities); In re Vertical Mac Constr., LLC, 2021 WL 3668037, at *3 (concluding that maintenance of bank accounts, working with insurance adjusters and defense counsel to resolve claims, and selling assets all qualified as commercial or business activities); In re Port Arthur Steam Energy, L.P., 629 B.R. at 237 (concluding that actively pursuing litigation against a third party, collecting outstanding accounts receivable, maintaining its facility, selling an asset, and filing tax returns all qualified as commercial or business activities); In re Blue, 630 B.R. at 190 (concluding that debtor was engaged in business activities by working as an IT consultant for a non-related entity and by winding down her former IT business); In re Offer Space, LLC, 629 B.R. at 306-07 (while debtor was no longer operating, had no employees, had no intention to reorganize, and intended to liquidate any remaining assets, debtor was engaged in commercial or business activities by having active bank accounts and accounts receivable, exploring counterclaims in a pending lawsuit, managing its stock, and winding down its business and taking steps to pay creditors and realize value for its assets); In re Ikalowych, 629 B.R. at 284-85 (concluding that the W-2 wage-earner debtor performing wind down work and dealing with tax accountants and tax issues for his defunct LLC qualified as commercial or business activities).

Suffice it to say, courts are less likely to find sufficient commercial or business activities for purposes of § 1182(1) (A) where the debtor is an individual who owns a nonoperating business, especially where the business has been dissolved under applicable state law. SeeIn re Rickerson, 636 B.R. at 425-26 (concluding that individual whose entities had been inactive for years prepetition with no ongoing activity of any type and had no intent to reactivate any of the entities was not engaged in commercial or business activities); In re Johnson, 2021 WL 825156, at *7-8 (concluding that individual debtors were not engaged in commercial or business activities where husband's former companies were defunct and both debtors were now W-2 wage earners, even though husband was currently serving as president in a nonrelated business); In re Thurmon, 625 B.R. at 423 (concluding that individual debtors who sold their business prepetition, were retired, and did not intend to return to business were not engaged in commercial or business activities, and keeping their empty shell LLC in *411 good standing and the existence of accounts receivable was insufficient).

The bankruptcy court found that RS Air was engaged in commercial or business activities on the petition date by litigating with NetJets, paying its aircraft registry fees, remaining in good standing as a Delaware LLC, and filing its tax returns and paying taxes. In addition, RS Air intends to resume fractional jet ownership and flight operations with a different partner once able. We conclude that the activities identified by the bankruptcy court are "commercial or business activities" within the meaning of § 1182(1)(A). And the bankruptcy court correctly found that RS Air was "engaged in" these activities on the petition date. While NetJets wishes to split hairs about the degree of RS Air's involvement in the Ohio litigation prior to and on the petition date, we do not view that factual issue as determinative.

NetJets argues that RS Air was not engaged in commercial or business activities either on or before the petition date because RS Air's activities lacked any motive to generate income or profit. NetJets contends that, to establish eligibility for subchapter V, the debtor must have a profit motive. Thus, the question is whether engaging in commercial or business activities incorporates a "pursuit of profit" requirement.

NetJets cherry-picks cases which it argues support its position that an eligible subchapter V debtor must have the intent to pursue profit. In re Vertical Mac Constr., LLC, 2021 WL 3668037, at *3 (noting that the term "commercial" is commonly understood to involve commerce, and includes "occupied with or engaged in commerce or work intended for commerce," "of or relating to commerce," and "viewed with regard to profit"); In re Port Arthur Steam Energy, L.P., 629 B.R. at 236 (same); In re Blue, 630 B.R. at 189 (noting that "a person is engaged in commercial or business activities when she participates in the purchasing or selling of economic goods or services for a profit"); In re Ikalowych, 629 B.R. at 276 (holding that commercial or business activities means "any private sector actions related to buying, selling, financing, or using goods, property, or services, undertaken for the purpose of earning income"); In re Johnson, 2021 WL 825156, at *8 (a person engaged in commercial or business activities is "a person engaged in the exchange or buying and selling of economic goods or services for profit").

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In addition to discussing the definition for the word "commercial," the courts above went on to discuss the definition for the word "business," which is defined as "a usually commercial or mercantile activity engaged in as a means of livelihood," or "dealings or transactions especially of an **economic nature**." *Business*, Merriam-Webster Online Dictionary, https://www.merriamwebster.com/dictionary/business (last visited Mar. 29, 2022) (emphasis added). Certainly, the depreciation tax benefits and the revenue generated by RS Air's flight operations or its acquiring and selling of its fractional aircraft interests are "dealings or transactions" of an "economic nature." Although NetJets tries to argue that no real tax benefit exists, that is contrary to its marketing strategy which touted tax benefits as a key advantage for fractional jet ownership.

Further, NetJets fails to note that the *Ikalowych* court went on to observe that § 1182(1)(A) speaks only to whether the debtor was engaged in commercial or business activities — "not whether the [d]ebtor was making a profit, actively operating, or intending to operate in the future." 629 B.R. at 285. That court further heeded:

Interpretation of statutory phrases can be aided by considering the definitions *412 of each of the words in a phrase; but simply stringing separate dictionary definitions together is not enough and might lead in the wrong direction. Instead, the Court must consider context and purpose in applying definitions.

Id. at 278. The court in *Blue* was also careful not to limit the meaning of "commercial or business activities" to basic dictionary definitions. 630 B.R. at 188-89.

Finally, the issue of a "profit motive" was not directly addressed in these cases. The few courts that have addressed it have held that § 1182(1)(A) does not require a debtor to be engaged in for-profit business to qualify for subchapter V. In Ellingsworth Residential Community Association, 619 B.R. 519, 520 (Bankr. M.D. Fla. 2020), an unsecured creditor argued that the debtor – a nonprofit homeowners association - was not eligible for subchapter V because, as a nonprofit, it did not "engage in commercial or business activities." The bankruptcy court disagreed and found that, based on the plain and unambiguous language of the statute, no profit motive is required. Id. at 521. It went on to hold that the many commercial or business activities the nonprofit debtor engaged in fit the "broad" categorization of such activities. *Id.* (e.g., contracting for goods and services, hiring professionals, filing regular tax returns, collecting assessments from its homeowners).

On appeal, the district court affirmed. Guan v. Ellingsworth Residential Cmtv. Ass'n (In re Ellingsworth Residential Cmtv. Ass'n), No. 6:20-cv-1243-WWB, 2021 WL 3908525, at *3 (M.D. Fla. Aug. 19, 2021), appeal dismissed, No. 21-12970-AA, 2021 WL 6808445 (11th Cir. Nov. 4, 2021). The district court reasoned that, although corporations involved in commerce can, and frequently do, have a profit motivation, the plain and ordinary meaning of the terms "commercial or business activities" does not require it. For support, the district court cited to Black's Law Dictionary, which notes that "business activities" can be either "the carrying out of a series of similar acts for the purpose of realizing a pecuniary benefit, or otherwise accomplishing a goal." Id. (quoting Doing Business, Black's Law Dictionary (11th ed. 2019)). This broad definition would include not-for-profit businesses, and would not be limited to those having only a benevolent purpose.

The bankruptcy court in *Family Friendly Contracting LLC* also concluded that the plain and ordinary meaning of "commercial or business activities" does not require a profit motivation. 2021 WL 5540887, at *3. In so ruling, the court observed that courts have interpreted the phrase broadly in keeping with the SBRA's purpose and the language of § 1182(1)(A).

We note, and the *Ellingsworth* and *Family Friendly* courts observed, Congress chose not to exclude nonprofits or other persons who lack a profit motive from qualifying for subchapter V. And that makes sense, because churches, hospitals, and other nonprofit businesses are allowed to file for chapter 11 (or 7) relief. SeeJBB Holdings, LLC v. Abundant Life Worship Ctr. of Hinesville, GA, Inc. (In re Abundant Life Worship Ctr. of Hinesville, GA, Inc.), No. 20-40959-EJC, 2020 WL 7635272, at *10 n.23 (Bankr. S.D. Ga. Dec. 16, 2020) (a church or other nonprofit entity can be a small business debtor) (citing In re Ellingsworth Residential Cmty. Ass'n, 619 B.R. at 521-22); In re Charles St. African Methodist Episcopal Church of Bos., 478 B.R. 73 (Bankr. D. Mass. 2012) (religious corporation's nonprofit status did not disqualify it as a "corporation" eligible for chapter 11); see also§ 101(27A) defining "health care business" to include an entity "organized for profit or not for profit"); *413 2 Collier on Bankruptcy ¶ 109.02 (Alan N. Resnick & Henry J. Sommer, eds. 16th ed. rev. 2021) ("a nonprofit corporation, like a for-profit corporation, is eligible to file for relief under the Code"). The only persons Congress excluded from subchapter V eligibility (other than by debt

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limitations) are those whose primary activity is the business of owning single asset real estate, corporate debtors subject to reporting requirements under certain sections of the Securities Exchange Act (15 U.S.C. §§ 78m or 78o(d)), or any debtor that is an affiliate of an issuer under 15 U.S.C. § 78c. See § 1182(1)(A) & (B).

[10] Accordingly, we conclude that no profit motive is required for a debtor to qualify for subchapter V relief. To hold otherwise would wrongfully exclude nonprofits and other persons that lack such a motive. That RS Air had no profit motive did not render it ineligible for subchapter V.

B. The bankruptcy court erred by allocating the burden to NetJets to prove that RS Air was not eligible for subchapter V.

The parties dispute who had the burden of proof as to RS Air's subchapter V eligibility: RS Air or NetJets. The Bankruptcy Code and Rules are silent on this issue. The bankruptcy court determined that NetJets, as the party challenging eligibility, had the burden. NetJets contends this was error. We agree.

The bankruptcy court rejected the Missouri bankruptcy case cited by NetJets - In re Thurmon - as contrary to Ninth Circuit law. Thurmon held, based on Eighth Circuit law, that the debtor has the burden to establish subchapter V eligibility. 625 B.R. at 419 n.4. The bankruptcy court believed it was bound by Scovis v. Henrichsen (In re Scovis), 249 F.3d 975 (9th Cir. 2001), which it cited for the proposition that the party challenging chapter 13 eligibility under § 109(e) bears the burden of proof. However, Scovis made no express, or even implied, ruling as to who has the burden of proof for establishing eligibility under § 109(e) outside of the context of plan confirmation. The bankruptcy court also relied on BAP cases involving motions to dismiss under § 707 and § 1112. SeeAspen Skiing Co. v. Cherrett (In re Cherrett), 523 B.R. 660, 668 (9th Cir. BAP 2014) (movant bears the burden to establish abusive chapter 7 filing under § 707(b) (1)); Sullivan v. Harnisch (In re Sullivan), 522 B.R. 604, 614 (9th Cir BAP 2014) (movant bears the burden to establish "cause" for dismissal of chapter 11 case under § 1112(b)).

Neither this Panel nor the Ninth Circuit Court of Appeals has decided the issue of who has the burden on subchapter V eligibility. However, in an objection to the debtor's eligibility for chapter 9 relief, we held that the debtor has the burden of establishing eligibility under § 109(c). *In re City of Vallejo*, 408 B.R. at 289 (citing *In re Valley Health Sys.*, 383 B.R. 156, 161 (Bankr. C.D. Cal. 2008)). Other circuit courts, as

well as courts within this circuit, have held that the debtor has the burden of establishing eligibility for chapter 12 relief under § 109(f). SeeFirst Nat'l Bank of Durango v. Woods (In re Woods), 743 F.3d 689, 705 (10th Cir. 2014) (citing cases); Tim Wargo & Sons, Inc. v. Equitable Life Assurance Soc'y of the U.S. (In re Tim Wargo & Sons, Inc.), 869 F.2d 1128, 1130 (8th Cir. 1989); Baker v. Rosenberger (In re Rosenberger), No. 20-50093, 2020 WL 6940926, at *3 (Bankr. W.D. Va. Sept. 29, 2020) (debtor must put forward sufficient evidence to allow the court to find that she satisfies § 109(f) eligibility requirements, including the definitional § 101(18) requirement that she was "engaged in a farming operation" on the petition *414 date); In re Cooper, No. 10-66447-fra12, 2011 WL 3882278, at *1 (Bankr. D. Or. Sept. 2, 2011); In re Powers, No. 10-14557, 2011 WL 3663948, at *1 (Bankr. N.D. Cal. Aug. 12, 2011) ("The party filing a petition under Chapter 12 bears the burden of proving eligibility."); In re Pandol, No. 10-19733-B-12, 2010 WL 9488147, at *1 (Bankr. E.D. Cal. Sept. 29, 2010) (debtor has the burden to establish that he is a "family farmer"). Finally, in involuntary cases, our circuit places the burden of proving eligibility on the petitioning creditors. Cunningham v. Rothery (In re Rothery), 143 F.3d 546, 548 (9th Cir. 1998) ("The filing of an involuntary case requires the petitioning creditor to meet the burden of proof on the main elements under § 303."); Hayden v. QDOS, Inc. (In re QDOS, Inc.), 607 B.R. 338, 343 (9th Cir. BAP 2019).

[11] The reasoning of the courts placing the burden on the debtor to establish eligibility for relief in a chapter 12 case is persuasive for our purposes here, considering that chapter 12 contains the analogous requirement that a "family farmer" be "engaged in a farming operation" to be eligible. See \ 101(18). Nearly every court deciding the issue of who bears the burden of proving eligibility for subchapter V has held that it is the debtor. SeeIn re Rickerson, 636 B.R. at 422; In re Family Friendly Contracting LLC, 2021 WL 5540887, at *2; In re Vertical Mac Constr., 2021 WL 3668037, at *2; In re Port Arthur Steam Energy, L.P., 629 B.R. at 235; In re Blue, 630 B.R. at 187; In re Offer Space, LLC, 629 B.R. at 304; In re Ikalowych, 629 B.R. at 275; In re Sullivan, 626 B.R. 326, 330 (Bankr. D. Colo. 2021); In re Johnson, 2021 WL 825156, at *4; In re Thurmon, 625 B.R. at 419 n.4; In re Blanchard, 2020 WL 4032411, at *2; In re Wright, 2020 WL 2193240, at *2; but seeIn re Body Transit, Inc., 613 B.R. 400, 409 n.15 (Bankr. E.D. Pa. 2020) (objecting party is the de facto moving party bearing the burden to prove the debtor is not entitled to subchapter V relief); Hall L.A. WTS, LLC v. Serendipity Labs, Inc. (In re Serendipity Labs, Inc.), 620 B.R. 679, 680

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n.3 (Bankr. N.D. Ga. 2020). We agree with the majority view and hold that the burden to prove eligibility for subchapter V should be placed on the debtor, especially considering the many advantages subchapter V offers debtors over a "traditional" chapter 11: total plan exclusivity (including modifications) and no disclosure statement requirement; the ability to obtain a discharge on the effective date; and the inapplicability of the absolute priority rule. It also makes sense to place the burden on the debtor because debtors are in the best position to prove that they are qualified to be in subchapter V.⁶

We note the case of *Ho v. Dowell (In re Ho)*, 274 B.R. 867 (9th Cir. BAP 2002), cited by RS Air. The thrust of that case was a debtor's eligibility to proceed under chapter 13 given the debt limits set by § 109(e). The concurrence noted that a creditor has the burden to persuade the court to grant a motion to dismiss a chapter 13 case for § 109(e) ineligibility, whereas the debtor has the burden of demonstrating § 109(e) eligibility for purposes of plan confirmation. *Id.* at 882-83. The majority did not comment on this issue. In any case, we are not bound by *Ho*. The statement is dicta in a concurrence. Further, the bankruptcy court's ruling on RS Air's subchapter V eligibility was not in the context of a motion to dismiss where one might expect the movant to have the burden.

[12] Nevertheless, the bankruptcy court's error in allocating the burden to NetJets in the objection to eligibility was harmless because RS Air met its burden. RS Air demonstrated that it was engaged in commercial or business activities on the petition date, which was the only criterion challenged by NetJets on eligibility.

*415 C. The bankruptcy court failed to recognize the exceptions to the law of the case doctrine, but such error was harmless.

[13] [14] [15] The doctrine of law of the case provides that a "court is generally precluded from reconsidering an issue that has already been decided by the same court, or a higher court in the identical case." *Thomas v. Bible*, 983 F.2d 152, 154 (9th Cir. 1993). To apply, "the issue in question must have been decided either expressly or by necessary implication in the previous disposition." *Id.* (cleaned up). But there are exceptions to this discretionary doctrine. A court may revisit a previously resolved question when: (1) the first decision was clearly erroneous; (2) an intervening change in the law has occurred; (3) the evidence on remand is substantially different; (4) other changed circumstances exist; or (5) a

manifest injustice would otherwise result. *Id.* at 155 (citations omitted).

NetJets argues that the bankruptcy court abused its discretion by applying law of the case to its earlier ruling that RS Air was eligible for subchapter V, when new evidence presented at the final confirmation hearing defeated RS Air's eligibility. NetJets argues that the bankruptcy court failed to consider new evidence that: (1) RS Air had not reported any income since at least 2004; (2) Perlman's alleged tax benefit flowing from his ownership of RS Air was not a benefit and but rather a loss because the cost of producing the benefit exceeded the amount of the tax benefit itself; (3) the financial model supporting RS Air's income calculations treated expenses as "income," did not comply with GAAP, and was inconsistent with the definition of "disposable income" under the Code; and (4) RS Air's disposable income would be negative using a strict definition of "disposable income." NetJets contends that the bankruptcy court's decision was particularly egregious because the subchapter V designation was an interlocutory ruling. SeeAmarel v. Connell, 102 F.3d 1494, 1515 (9th Cir. 1996) (interlocutory orders are subject to modification at any time prior to final judgment); Hydranautics v. FilmTec Corp., 306 F. Supp. 2d 958, 968 (S.D. Cal. 2003) (court may reconsider and revise an interlocutory decision for any reason, even absent new evidence or an intervening change in the law).

[16] The problem facing NetJets is that all of the alleged new evidence it argues that the bankruptcy court should have considered relates to the fact that RS Air had no net profit. As we stated above, a profit motive or net profit is not required for subchapter V eligibility. In addition, much of this evidence was not "new." In overruling NetJets' initial objection, the bankruptcy court found that RS Air was created to receive a depreciation tax benefit marketed by NetJets rather than to generate a net profit. At a prior confirmation hearing, Perlman testified that RS Air would likely have no projected disposable income within the next five years, if ever. We also find it somewhat disingenuous for NetJets to complain about this purported new evidence that was consistent with its long-standing argument that RS Air was not a business with income, and consistent with RS Air's position that jet share ownership's primary business value is a tax benefit, not income. Accordingly, any failure by the bankruptcy court in not considering the exceptions to law of the case was harmless

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CONCLUSION

For the reasons stated above, we AFFIRM both the Subchapter V Order and the Confirmation Order.

All Citations

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KeyCite Yellow Flag - Negative Treatment
Distinguished by In re RS Air, LLC, 9th Cir.BAP (Cal.), April 26, 2022
625 B.R. 417

United States Bankruptcy Court, W.D. Missouri.

IN RE: Kevin Lynn THURMON and Susan Jane Thurmon, Debtors.

Case No. 20-41400-can11 | Signed December 8, 2020

Synopsis

Background: Married individuals whose limited liability company (LLC) had operated two pharmacies but who had ceased operating their business, sold its assets, and retired before seeking bankruptcy relief some three months later, elected to file as subchapter V small business debtors. The United States Trustee (UST) objected to the designation and filed limited objection to confirmation of debtors' consensual plan.

Holdings: The Bankruptcy Court, Cynthia A. Norton, Chief Judge, held that:

- [1] as a matter of first impression for the court, debtors were not "engaged" in commercial or business activities and so were not eligible to be subchapter V small business debtors under the Small Business Reorganization Act of 2019 (SBRA), even if their LLC was still an entity in good standing under Missouri law and still owned some outstanding accounts receivable and two cars;
- [2] UST effectively waived its right to request that debtors file a disclosure statement; and
- [3] the proposed plan contained adequate information and so substantially complied with the section of the Bankruptcy Code governing postpetition disclosure and solicitation, even though it was not filed with a disclosure statement.

Designation objection sustained; confirmation objection overruled.

West Headnotes (12)

[1] Bankruptcy Peorganization cases

For purposes of the Small Business Reorganization Act of 2019 (SBRA), a "person" is defined to include individuals, partnerships, and corporations. 11 U.S.C.A. § 101(41); Pub. L. No. 116-54, 133 Stat. 1079.

[2] Bankruptcy Peorganization cases

Under the Small Business Reorganization Act of 2019 (SBRA), a subchapter V small business debtor is a person "engaged" in commercial or business activities, subject to certain debt limits and exclusions. 11 U.S.C.A. § 101(51D)(A); Pub. L. No. 116-54, 133 Stat. 1079.

13 Cases that cite this headnote

[3] Bankruptcy Peorganization cases

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) temporarily increases the debt limit for "small business debtors" under the Small Business Reorganization Act of 2019 (SBRA) to \$7,500,000. 11 U.S.C.A. § 1182(1) (A); Pub. L. No. 116-54, 133 Stat. 1079; Pub. L. No. 116-136, 134 Stat. 281.

[4] Bankruptcy Particular proceedings or issues

Objections to debtor's designation as small business debtor under the Small Business Reorganization Act of 2019 (SBRA) is core proceeding. Pub. L. No. 116-54, 133 Stat. 1079.

3 Cases that cite this headnote

[5] Bankruptcy > Evidence and fact questions

Parties who filed Chapter 11 petition and elected small business debtor designation pursuant to the Small Business Reorganization Act of 2019 (SBRA) bore burden to prove their eligibility for such relief. Pub. L. No. 116-54, 133 Stat. 1079.

1

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[6] Bankruptcy Peorganization cases

Chapter 11 debtors, married individuals whose limited liability company (LLC) had operated two pharmacies but who had ceased operating their business, sold its assets, and retired prepetition, were not "engaged" in commercial or business activities and so were not eligible to be subchapter V "small business debtors" under the Small Business Reorganization Act of 2019 (SBRA); even if debtors' LLC was still entity in good standing under Missouri law and still owned some outstanding accounts receivable and two cars, debtors were not actively and currently involved in business, as implicitly required to fall within statutory definition, because they had sold their business with no intent to return to it and were otherwise not active or involved in any commercial or business activities. 11 U.S.C.A. §§ 101(51D), 1182(1)(A).

11 Cases that cite this headnote

[7] Statutes 🕪 Undefined terms

When Congress does not define a statutory term, courts rely on the word or phrase's plain meaning or common understanding.

1 Case that cites this headnote

[8] Bankruptcy Peorganization cases

Congress knew how to restrict recourse to the avenues of bankruptcy relief; it did not place Chapter 11 reorganization beyond the reach of a nonbusiness individual debtor.

[9] Bankruptcy - Reorganization cases

Where bankruptcy court granted United States Trustee's (UST) objection to Chapter 11 debtors' designation as subchapter V "small business debtors," effective as of that date, debtors would proceed as regular Chapter 11 debtors. Fed. R. Bankr. P. 1020(a).

2 Cases that cite this headnote

[10] Bankruptcy Pankruptcy Confirmation; Objections

United States Trustee (UST), in its late-filed objection to Chapter 11 debtors' consensual plan, effectively waived its right to request that they file a disclosure statement; debtors were subchapter V small business debtors when they filed the plan without a disclosure statement, as such debtors were not required to file a disclosure statement and their plan was compliant with the Bankruptcy Code and rules when filed, and UST, despite having raised a "subchapter V" eligibility objection months earlier, which the bankruptcy court ultimately sustained, never requested that the court require debtors to file a disclosure statement. 11 U.S.C.A. §§ 1125, 1181(b); Fed. R. Bankr. P. 1020.

[11] Bankruptcy Proceedings for approval; objections

Consensual Chapter 11 plan filed by debtors when they initially sought bankruptcy relief as subchapter V small business debtors substantially complied with the requirements of the section of the Bankruptcy Code governing postpetition disclosure and solicitation, even though it was not filed with a disclosure statement, and so the plan could be confirmed without further delay when the bankruptcy court later granted United States Trustee's (UST) objection to debtors' designation as subchapter V small business debtors, with the result that they would be proceeding as regular Chapter 11 debtors, where no party requested that the court make that section of the Code applicable, the only "adequate information" that the plan lacked related to feasibility, and the court accepted a proffer at the hearing related to feasibility. 11 U.S.C.A. §§ 1125, 1181(b); Fed. R. Bankr. P. 1020.

[12] Bankruptcy 🕪 Trustees

Where bankruptcy court granted United States Trustee's (UST) objection to Chapter 11 debtors'

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designation as subchapter V "small business debtors," with the result that, effective as of that date, debtors would proceed as regular Chapter 11 debtors, debtors were required to comply with the requirement to pay UST quarterly fees, and would have to include appropriate language modifying their consensual plan in their proposed order of confirmation. 11 U.S.C.A. § 1129(a)(12); Fed. R. Bankr. P. 1020.

Attorneys and Law Firms

*419 Bradley D. McCormack, The Sader Law Firm, LLC, Kansas City, MO, for Debtors.

George Matthew Barberich, Jr., Kansas City, MO, Pro Se.

MEMORANDUM OPINION AND ORDER SUSTAINING THE UNITED STATES TRUSTEE'S OBJECTION TO DEBTORS' DESIGNATION AS A SUBCHAPTER V SMALL BUSINESS DEBTOR AND OVERRULING THE UNITED STATES TRUSTEE'S LIMITED OBJECTION TO CONFIRMATION

Cynthia A. Norton, U.S. Bankruptcy Judge

[3] Under the Small Business Reorganization [1] Act of 2019, 1 Congress authorized eligible persons² to avail themselves of streamlined chapter 11 bankruptcy relief designed to help small businesses. Subject to certain debt limits and exclusions not pertinent here,³ a subchapter V small business debtor is a person "engaged in commercial or business activities." The United States Trustee ("UST") objects to these individual debtors' designation as subchapter V small business debtors because they ceased operating their business, sold the assets several months before they filed this case, and are now retired. The UST argues that the debtors therefore are not "engaged" in commercial or business activities. The debtors respond that they nonetheless qualify because the definition does not require them to be "currently engaged" in commercial or business activities. The court agrees with the UST.

- Small Business Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079 (2019), or "SBRA" for short. SBRA became effective February 19, 2020.
- A "person" is defined to include individuals, partnerships, and corporations. 11 U.S.C. § 101(41).
- Under SBRA, a "small business debtor" is defined as a person engaged in commercial or business activities "that has aggregate noncontingent liquidated secured and unsecured debts ... of not more than \$2,725,625," with certain other requirements and exceptions not relevant here. 11 U.S.C. § 101(51D)(A). The Coronavirus Aid, Relief, and Economic Security Act, or CARES Act, Pub. L. No. 116-136, 134 Stat. 281 (2020) enacted on March 27, 2020, temporarily increases the debt limit to \$7,500,000. 11 U.S.C. § 1182(1)(A).

Findings of Fact

- [4] [5] The parties agreed to submit the issue to the court based on briefing, stipulated facts, and oral argument.⁴ The court incorporates herein the *Joint Stipulation of Facts* filed by the UST; the debtors Kevin and Susan Thurmon; the subchapter V trustee, Matt Barberich, Jr.; and the primary secured creditor, Dollar Signs, Inc ("DSI").⁵
- No party disputes that the court has jurisdiction to hear and determine this matter and that objections to a debtor's designation as a small business debtor is a core proceeding. See In re Blanchard, No. 19-12440, 2020 WL 4032411, at *2 (Bankr. E.D. La. July 16, 2020). As the parties who filed the petition and elected the subchapter V small business debtor election, the Thurmons bear the burden to prove their eligibility under applicable Eighth Circuit authority. Montgomery v. Ryan (In re Montgomery), 37 F.3d 413, 415 (8th Cir. 1994). Contra In re Body Transit, Inc., 613 B.R. 400, 409, n. 15 (Bankr. E.D. Pa. 2020) (objecting party is the de facto moving party bearing the burden to prove debtor not entitled to subchapter V small business debtor relief).
- 5 ECF No. 74.

*420 Events Pre-Bankruptcy

Without repeating in whole cloth what is in the *Joint Stipulation*, the short story is that the Thurmons are married residents of Missouri. Together they own 70% of Dowel, LLC, a Missouri limited liability company. For almost four years, Dowel, LLC operated two pharmacies in Higginsville, Missouri. In April 2020, Dowel, LLC closed the pharmacies

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and sold almost all the business assets, leaving a substantial deficiency to DSI along with some other business debts.

When the Thurmons filed a voluntary petition for chapter 11 relief some three months later, in early August 2020, Dowel, LLC had no employees, no customers, no vendors, and no intent to resume business activities. Dowel, LLC still owns some outstanding accounts receivable and two cars. DSI retains its liens on those assets. Although Dowel, LLC is not operating, it is still an entity in good standing under Missouri law.

Events Post-Bankruptcy

The Thurmons elected to file chapter 11 as subchapter V small business debtors by so designating on their petition. Their debts do not exceed \$7,500,000. Since the filing they have complied with the provisions of subchapter V by timely filing their § 1116(1) documents,⁶ the subchapter V status report,⁷ all monthly operating reports,⁸ and a plan,⁹ and by attending the subchapter V status conference.¹⁰ The plan is a consensual plan that all voting classes of impaired claims, including DSI's, have voted to accept.

- ECF Nos. 30, 31; see 11 U.S.C. § 1187(a) ("Upon electing to be a debtor under this subchapter, the debtor shall file the documents required by subparagraphs (A) and (B) of section 1116(1) of this title.").
- FCF No. 53; see 11 U.S.C. § 1188(c) ("Not later than 14 days before the date of the status conference under subsection (c), the debtor shall file with the court and serve on the trustee and all the parties in interest a report that details the efforts the debtor has undertaken and will undertake to attain a consensual plan of reorganization.").
- ECF Nos. 44, 62, and 82; see 11 U.S.C. § 1187(b) ("A debtor, in addition to the duties provided in this title and as otherwise required by law, shall comply with the requirements of section 308 and paragraphs (2), (3), (4), (5), (6) and (7) of section 1116 of this title."). See also 11 U.S.C. § 308(b) (specifying the reports a debtor in a small business case must file).
- ECF No. 76; see 11 U.S.C. § 1189(b) ("The debtor shall file a plan not later than 90 days after the order for relief.").
- ECF Nos. 19, 65; see 11 U.S.C. § 1188(a) ("[N]ot later than 60 days after the order for relief under this chapter, the court shall hold a status conference to further

expeditious and economical resolution of a case under this subchapter.")

In the meantime, the UST timely objected to the Thurmons' subchapter V small business debtor designation. DSI originally joined the UST's objection, but has now withdrawn its joinder. The UST has also filed a limited objection to confirmation of the plan to preserve his eligibility argument. He also asserts that if the court strikes the subchapter V designation, the plan as filed cannot be confirmed since it lacks a disclosure statement and does not provide for payment of the UST quarterly fees, as would be required in a nonsubchapter V chapter 11 case. ¹¹

See 11 U.S.C. §§ 1129(a)(1) (as it incorporates § 1125) and (a)(12).

Discussion

[6] The parties agree that the only issue regarding eligibility in this case is whether the Thurmons "are engaged in commercial or business activities" within *421 the meaning of the Bankruptcy Code. 12 The Thurmons make three arguments: (1) the statutory definition of a small business debtor does not say that debtors must be "currently" engaged in business; (2) even if construed that way, they are engaged in business activity since Dowel, LLC is still an entity in good standing; and (3) all the cases thus far unanimously agree that debtors does not have to be "currently" engaged in business to qualify for subchapter V small business relief.

The definition of small business debtor with the increased debt limit is currently found in § 1182(1)(A), enacted as part of the CARES Act; prior to the CARES Act, the definition was in § 101(51D). The CARES Act provisions relating to the increased debt limit are currently set to sunset one year after enactment, or by March 27, 2021.

The Thurmons are correct that since February 19, 2020 when subchapter V relief first became available, the only cases to decide the issue have agreed with their interpretation. ¹³ The court declines to follow those cases, however. The problem with the Thurmons' position is that Congress was not writing on a blank slate when it unveiled subchapter V small business debtor relief in 2020. Several long existing provisions of the Bankruptcy Code use similar "engaged in" language, as do numerous other federal statutes. ¹⁴

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- 13 See In re Wright, No. 20-01035, 2020 WL 2193240 (Bankr. D.S.C. April 27, 2020); In re Bonert, 619 B.R. 248 (Bankr. C.D. Cal. 2020) (following Wright); In re Blanchard, No. 19-12440, 2020 WL 4032411 (Bankr. E.D. La. July 16, 2020) (same).
- See, e.g., 33 U.S.C. § 902(3), for employee to be covered by the Longshore and Harbor Workers' Compensation Act, the person must be "engaged in maritime employment." McGray Construction Co. v. Director, Office of Workers Compensation Programs, 181 F.3d 1008, 1014 (9th Cir. 1999) (holding that the statutory term "person engaged in maritime employment" means "engaged" on "this job").

Under title 11, for example, § 101(18)(A), which defines persons eligible to file for streamlined and advantageous chapter 12 relief, requires a "family farmer" to be "engaged in a farming operation." A "health care provider" under § 101(27A)(A) must be "primarily engaged" in offered certain facilities and services. Section 101(44) defines a railroad to include a common carrier "engaged in the transportation of individuals or property."

- 15 See In re Watford, 898 F.2d 1525, 1528 (11th Cir. 1990) (adopting the totality of the circumstances test to decide whether a debtor intends to continue to engage in a farming operation for purposes of eligibility for chapter 12 even though not engaged in the physical activity of farming at the time the petition was filed); contra In re Armstrong, 812 F.2d 1024, 1028 (7th Cir. 1987).
- In re Banes, 355 B.R. 532, 535 (Bankr. M.D.N.C. 2006) (in determining whether a patient ombudsman should be appointed for a defunct dental practice, the court noted the definition of "health care business" in § 101(27A) as an entity that is "primarily engaged in offering" health care services was written in the present tense, indicating that Congress was concerned with appointing patient care ombudsmen "in cases where health care businesses seeking bankruptcy protection are currently engaged in the ongoing care of patients") (emphasis added).
- 17 In re Pittsburgh & Lake Erie Properties, Inc., 290 F.3d 516, 519-520 (3d Cir. 2002) (natural reading of definition of railroad is not for debtor to be a former railroad; the term "engaged in" is in present tense).

When Congress enacted chapter 12 in 1986, numerous courts struggled with what it meant to be "engaged in" farming. How involved in conduct of the farm operations did you have to be?¹⁸ What about passive *422 activities like

accepting rent from leased farmland?¹⁹ What if you were no longer farming?²⁰ Before these sections were added to the Bankruptcy Code, the U.S. Supreme Court in *Toibb v. Radloff*²¹ in 1991 grappled with whether to read into § 109 – eligibility for chapter 11 – whether a chapter 7 debtor had to be "engaged in business" to convert to chapter 11. (The short answer: No.) And so on.

- 18 E.g., Cottonport Bank v. Dichiara, 193 B.R. 798, 802 (W.D. La. 1996) (bankruptcy court did not err in finding that debtors who were actively involved in the planting and cultivation of sugar cane crop and who were entirely responsible for planting, cultivating, and harvesting of soybean crops were engaged in farming operations for purposes of chapter 12 eligibility).
- E.g., In re Morgan Strawberry Farm, 98 B.R. 584 (Bankr. M.D. Fla. 1989) (individual debtors who leased one farm for cash and suspended operations on another were not "engaged in" farming operation).
- 20 E.g., In re Tart, 73 B.R. 78 (Bankr. E.D.N.C. 1987) (people who had sold all their farmland prior to filing and who did not intend to resume any farming operations were not "engaged in" farm activities and did not qualify for chapter 12 relief); In re Haschke, 77 B.R. 223, 225 (Bankr. D. Neb. 1987) (same).
- 21 501 U.S. 157, 111 S.Ct. 2197, 2199, 115 L.Ed.2d 145 (1991).
- [7] In none of these cases, including *Toibb*, could this court find a precise definition of what the phrase "engaged in" standing alone means. ²² And that makes sense. We know that when Congress does not define a term, we rely on the word or phrase's plain meaning or common understanding. ²³ The plain meaning of "engaged in" means to be actively and currently involved. In § 1182(1)(A) of the Bankruptcy Code, "engaged in" is written not in the past or future but in the present tense. To add the word "currently" to the phrase "engaged in" would be redundant, because the currency of the involvement or activeness is inherent in the idea of being "engaged in" something.
- 22 Black's Law Dictionary (11th ed. 2019) defines "engage" as "[t]o employ or involve one's self; to take part in; to embark on." In a similar sense, Black's defines "engaged in commerce" for purposes of the "Fair Labor Standards Act and Federal Employers' Liability Act" to require the employee to be "actually engaged" in the movement of commerce (case authorities omitted). Likewise, an

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earlier *Black's* edition (5th ed. 1979) stated that "engaged in employment" means "[t]o be rendering service for employer under terms of employment," although that definition is absent in the most current edition.

23 E.g., United States v. Belmont, 831 F.3d 1098, 1100 (8th Cir. 2016) (interpreting the phrase "to engage in the business of importing, manufacturing, or dealing in explosive materials without a license" under 18 U.S.C. § 842(a)(1) in defendant's appeal of criminal conviction).

This sense of "engaged in" as incorporating currency is supported by early chapter 12 cases in this circuit. In In re Tim Wargo & Sons, Inc., 24 the Eighth Circuit examined whether a corporation qualified as a "family farmer" under (then) $\S 101(17)(B)$ (now $\S 101(18)(B)$). That subsection analogously requires that the family members or relatives who own the corporate entity must "conduct" the farming operation. The Eight Circuit observed that to "conduct" farming, some member of the family at a minimum had to play "an active role in the farming operating taking place on the land."²⁵ The court compared the active role required to "conduct" a farming operation with being "engaged in" a farming operation, observing that both phrases require "an active role in the operation." 26 Similarly, in discussing whether certain income and debts qualified as arising out of *423 a farming operation, the Eighth Circuit in In re Easton, 27 reversed and remanded for the bankruptcy court to examine the nature of the income and debts, stating:

Those sums cannot be counted as § 101(17)(A) income unless debtors show that they had *some significant degree* of engagement in, played some significant operational role in, or had an ownership interest in the crop production which took place on the [rented] acreage.

(emphasis added).

- 24 In re Tim Wargo & Sons, Inc., 869 F.2d 1128 (8th Cir. 1989).
- 25 869 F.2d at 1130 (citing In re Burke, 81 B.R. 971, 976 (Bankr. S.D. Iowa 1987)).
- 26 _{Id}
- 27 In re Easton, 883 F.2d 630, 636 (8th Cir. 1989). See also In re Fenske, 96 B.R. 244, 247 (Bankr. D.N.D. 1988) (holding farmers who enrolled in CRP programs could still qualify as family farmers, noting "[t]hose individuals who while actively engaging in farming, avail themselves of such programs and thereby maximize the profitability of their operations are no less engaged in

a farming operation.") (emphasis added); *In re Paul*, 83 B.R. 709, 713 (Bankr. D.N.D. 1988) (recognizing that chapter 12 allows a debtor to scale down their core farming operation, but this "would not be applied to bring debtors who have abandoned their farming operation and have no intention of returning to traditional agricultural production under the protection of Chapter 12"). *Cf. In re Johnson*, 230 B.R. 608, 609 (B.A.P. 8th Cir. 1999) (discussing test for exempting farm tools of trade for purposes of lien avoidance under § 522(f); to be a farmer there must be evidence that the debtor legitimately engaged in a trade which *currently and regularly* uses the specific implements to be exempted) (*citing Production Credit Assoc. of St. Cloud v. La Fond (In re LaFond)*, 791 F.2d 623, 625 (8th Cir. 1986)) (emphasis added).

[8] In sum, as the Supreme Court in *Toibb* pointed out, "Congress knew how to restrict recourse to the avenues of bankruptcy relief; it did not place Chapter 11 reorganization beyond the reach of a nonbusiness individual debtor."28 Conversely, if Congress had intended to make all debtors with business debts below the debt cap eligible for subchapter V small business relief regardless of whether the business was still operating, it could have done so. But to read § 1182(1)(A) the way the Thurmons do renders the phrase "engaged in commercial or business activities" superfluous. The Thurmons were not as a matter of fact or law "engaged in commercial or business activities" on the day they filed bankruptcy because they had in fact sold the business with no intent to return to it and were otherwise not active or involved in any commercial or business activities.²⁹ For the same reason, keeping the empty shell of the former business entity open with the Missouri Secretary of State's office does not render them "engaged" in business activities, either.

- 28 111 S.Ct. at 2199.
- The UST also makes the point that merely paying off residual business debt cannot constitute being engaged in business or commercial activities under the definition of small business debtor in § 1182(1)(A). Although not discussed in this opinion because the nature and amount of the Thurmons' debts are not at issue, § 1182(1)(A) also requires that a small business debtor have debts "not less than 50 percent of which arose from the commercial or business activities of the debtor." See In re Wright, No. 20-01035, 2020 WL 2193240, at *3 (Bankr. D.S.C. April 27, 2020) (holding that the restructuring of residual business debt constitutes being engaged in commercial or business activities). The reasoning in Wright renders the debt requirements in § 1182(1)(A) superfluous.

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[9] The court is therefore compelled to grant the UST's objection to the Thurmons' subchapter V small business debtor designation, which means that, effective as of this date, the Thurmons now proceed as regular chapter 11 debtors. 30

30 Fed. R. Bankr. Proc. 1020(a).

[10] That takes us to the UST's late-filed objection to confirmation. The UST is the only party objecting to the Thurmons' consensual plan, which would otherwise be *424 ready to confirm. The UST objects that the plan is not confirmable because it is not accompanied by a disclosure statement and does not provide for payment of UST fees, as would be required in a nonsubchapter V chapter 11 case. The court overrules the UST's objection.

First, Rule 1020 says a debtor is entitled to proceed as a subchapter V small business debtor "unless and until" the court enters an order finding that debtor's statement is incorrect. The Thurmons were subchapter V small business debtors when they filed the plan without a disclosure statement, since § 1125 is expressly not applicable to subchapter V small business debtors unless the court for cause orders otherwise. The plan the Thurmons filed was compliant with the Code and Rules when the plan was filed. Despite having raised an eligibility objection months ago, the UST never requested that the court require the Thurmons to file a disclosure statement. The court finds that the UST has in essence waived the right to request a disclosure statement at this late date.

- 31 11 U.S.C. § 1181(b).
- The UST's objection to the designation was filed on August 20, 2020. ECF No. 40.
- 33 See 28 U.S.C. § 586(a)(3)(B).

[11] Second, the plan itself substantially complies with § 1125 by containing adequate information. The only "adequate information" within the meaning of § 1125 that the Thurmons' plan lacks relates to feasibility and the court accepted a proffer at the hearing related to feasibility. It would make no sense for confirmation of the plan to be delayed for the filing of a separate disclosure statement when all voting impaired creditors voted in favor of the plan and no party requested the court make § 1125 applicable, ³⁴ suggesting that the information in the plan was adequate for the creditors to determine how to vote. Even if the court required a disclosure statement at this late date, that would not necessarily cause

the plan to be reballoted. And there is some limited authority for the proposition that when acceptances or rejections are not required and are not solicited, a disclosure statement likewise should not be required.³⁵

- 34 See 11 U.S.C. § 1181(b): Section 1125 is not applicable, unless the court for cause orders otherwise.
- 35 See Collier on Bankruptcy ¶ 1125.02 (Richard Levin & Henry J. Sommer eds., 16th ed.), citing In re Colony Properties Int'l, LLC, 2011 WL 4443319, at *1–2, 2011 Bankr. LEXIS 3658, at *4 (Bankr. S.D. Cal. Sept. 19, 2011); In re Union County Wholesale Tobacco & Candy Co., 3 C.B.C. 2d 844, 8 B.R. 442, 443 (Bankr. D.N.J. 1981). But see In re Transload & Transport, 61 B.R. 379, 380 (Bankr. M.D. La. 1986).

[12] Accordingly, given the unusual circumstances of this case, the court will not require the Thurmons to file a disclosure statement for their consensual plan to be confirmed. The court does agree with the UST, however, that effective as of the date of this opinion, the Thurmons must comply with the requirement to pay the UST quarterly fees. To satisfy § 1129(a)(12), the Thurmons are ordered to include appropriate language modifying the plan in their proposed order of confirmation, due within 14 days.

Order

The court hereby sustains the UST's objection to the Thurmons' subchapter V election and finds that the Thurmons' statement in the petition as subchapter V small business debtors is incorrect under Rule 1020(a). The court overrules the UST's objection to confirmation of the Thurmons' chapter 11 plan; finds that the requirement to file a disclosure statement *425 has either been waived or is not applicable under the unusual circumstances of this case; and with the agreement of the parties to immediately proceed to confirmation, finds that the applicable requirements of § 1129(a) are otherwise met, subject to the requirement that the Thurmons include language in the order of confirmation to make the plan compliant with § 1129(a)(12). Proposed order due within 14 days.

IT IS SO ORDERED.

All Citations

625 B.R. 417, 69 Bankr.Ct.Dec. 165

In re Thurmon, 625 B.R. 417 (2020)

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In re Vertical Mac Construction, LLC, Not Reported in B.R. Rptr. (2021)

2021 WL 3668037

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IN RE: VERTICAL MAC CONSTRUCTION, LLC, Debtor.

Case No. 6:21-bk-01520-LVV

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ORDER OVERRULING UNITED STATES TRUSTEE'S OBJECTION TO DEBTOR'S SUBCHAPTER V ELECTION

Lori V. Vaughan, United States Bankruptcy Judge

*1 THIS CASE came before the Court on June 28, 2021, on the Objection to Debtor's Subchapter V Election (Doc. No. 51)("Objection") filed by the United States Trustee ("UST"). The UST contends that Vertical Mac Construction, LLC (the "Debtor") is not "engaged in commercial or business activities" and therefore not eligible to be a debtor under Subchapter V of Chapter 11. The issue before the Court is whether a debtor that ceased operating its business prepetition may still be eligible under Subchapter V. Having considered the undisputed facts and argument of counsel, the Court overrules the Objection. The Debtor is engaged in commercial or business activities as required under 11 U.S.C. § 1182 and may proceed with this Subchapter V Chapter 11 case.

Factual Background

The Debtor, a Florida limited liability company formed in 2007, is a contractor that specialized in stucco installations

for residential homes. In 2017, residential homeowners started alleging construction defect claims against the Debtor and others for improper stucco installation ("Construction Claims"). The Debtor's liability insurance covered the defense, however, as claims against the Debtor continued to increase, the Debtor could not renew its insurance or obtain replacement coverage. As a result, the Debtor ceased operations in late October 2020.

- 1 Doc. No. 12.
- 2 *Id.*
- 3 *Id.*
- 4 Doc. No. 51, ¶ 3; Doc. No. 61, ¶ 4.

On April 6, 2021 (the "Petition Date"), the Debtor filed this Chapter 11 case electing to proceed under Subchapter V.5 The Debtor sought bankruptcy protection to liquidate its assets and disburse the sale proceeds to creditors.⁶ Debtor's bankruptcy Schedule A/B disclosed assets valued at approximately \$300,000, consisting of bank accounts valued at approximately \$13,000, accounts receivable with a face value of \$200,000, vehicles and equipment valued at approximately \$75,000, and a \$20,000 stockholder receivable. Debtor's bankruptcy Schedule E/F disclosed unsecured claims of about \$800,000 and over 200 contingent, unliquidated and disputed Construction Claims. 8 Shortly after the Petition Date, the Debtor sought Court approval to sell assets free and clear of liens under 11 U.S.C. § 363, subject to higher and better offers, 9 which the Court granted after sufficient notice and hearing. ¹⁰ Prior to the Court's approval of the sale, the UST filed the Objection to Debtor's Subchapter V Election and the Debtor responded. 11

- 5 Doc. No. 1.
- 6 Doc. No. 12.
- Doc. No. 25, Schedule A/B.
- 8 Doc. No. 25, Schedule E/F.
- 9 Doc. No. 17.
- 10 Doc. No. 79.
- The Objection is Doc. No. 51. Debtor's response is Doc. No. 61.

In re Vertical Mac Construction, LLC, Not Reported in B.R. Rptr. (2021)

Debtor's Subchapter V Eligibility Under § 1182

The Small Business Reorganization Act of 2019 ("SBRA") added Subchapter V to Chapter 11 of the Bankruptcy Code, which provides small business debtors a new streamlined process to reorganize outside of the more costly traditional Chapter 11. Debtors electing to proceed under Subchapter V must qualify as:

[A] person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order of relief in an amount not more than \$7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor;...

*2 11 U.S.C. § 1182(1)(A) (emphasis added). If a party challenges the debtor's Subchapter V election, the debtor has the burden of proving eligibility. *In re Blue*, Case No. 21-80059, 2021 WL 1964085, *4 (Bankr. M.D. N.C. May 7, 2021); *In re Offer Space*, Case No. 20-27480, 2021 WL 1582625, *2 (Bankr. D. Utah Apr. 22, 2021); *In re Ikalowych*, Case No. 20-17547 TMB, 2021 WL 1433241, *7 (Bankr. D. Colo. Apr. 15, 2021). Here, the limited issue is whether the Debtor engaged in "commercial or business activities" as required under § 1182(1)(A).

The UST contends the Debtor is not eligible under Subchapter V because it no longer operated a business on the Petition Date. To support its Objection, the UST argues the Debtor ceased operations in October 2020, had not actively collected account receivables or pursued any lawsuits against third parties, had no intent to resume operations and had planned to sell substantially all its assets. In sum, the UST argues the Debtor is merely using Subchapter V to liquidate assets and not reorganize a business.

The Debtor responds that § 1182(1)(A) only requires the Debtor to be engaged in commercial or business "activities" and not operations. Although the Debtor no longer performs stucco installation services, the Debtor argues it still maintains a bank account, has accounts receivable, works with insurance adjusters and insurance defense counsel to resolve the Construction Claims, and has been preparing for the sale of its assets. The Debtor contends these activities

which occurred both prior to and after the Petition Date satisfy the inclusive "commercial or business activities" requirement of § 1182(1)(A) and render the Debtor eligible to proceed under Subchapter V. The Debtor further argues that "commercial or business activities" under § 1182(1)(A) need not be as of the Petition Date.

The Bankruptcy Code does not define the terms "engaged" or "commercial or business activities." The Court looks first to the plain language of the statute to determine the meaning of "engaged in commercial or business activities" as contemplated under § 1182(1)(A). Blue, 2021 WL 1964085 at *5; Offer Space, 2021 WL 1582625 at *3; Ellingsworth Residential Cmty. Ass'n, 619 B.R. 519, 521 (Bankr. M.D. Fla. 2020). A statute's undefined terms should be given their "ordinary, contemporary, common meaning" Offer Space, 2021 WL 1582625 at *3 (quoting In re Morreale, 959 F.3d 1002, 1007 (10th Cir. 2020)), with courts presuming the legislature "says in a statute what it means and means in a statute what it says there." Ellingsworth, 619 B.R. at 521 (quoting Connecticut National Bank v. Germain, 503 U.S. 249, 253-54 (1992)). And if the statute's plain language is unambiguous, the court's inquiry is then complete. Id. The Court holds that the statute's language is unambiguous.

The Court first takes up the term "engaged." The Debtor argues that it encompasses activities prepetition and does not require commercial or business activities on the Petition Date. Engaged means "involved in activity: occupied, busy." Engaged, Merriam-Webster.com Dictionary (www.merriamwebster.com/dictionary/engaged) (last updated July 8, 2021). Engaged is an active term, referring to the present and not the past. Had the drafters intended to refer to past activities, they would have written "was engaged" or "had engaged." This Court agrees with Port Arthur Steam Energy and other cases which hold "engaged" in commercial or business activities means the debtor actively had commercial or business activities on the petition date. In re Port Arthur Steam Energy, L.P. Case No. 21-60034, 2021 WL 2777993, *2 (Bankr. S.D. Tex. July 1, 2021) (citing Blue, 2021 WL 1964085 at *6; Offer Space, 2021 WL 1582625 at *3; In re Johnson, Case No. 19-42063, 2021 WL 825156, at *6 (Bankr. N.D. Tex. Mar. 1, 2021)). The Court now considers whether the Debtor was engaged in "commercial or business activities" as of the Petition Date.

*3 The terms that make up "commercial or business activities" likewise have long-standing common meanings. *Port Arthur Steam Energy*, 2021 WL 2777993, at *2. The term

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"commercial" is commonly understood to involve commerce. It includes "occupied with or engaged in commerce or work intended for commerce," "of or relating to commerce," and "viewed with regard to profit." *Commercial*, Merriam-Webster.com Dictionary (www.merriam-webster.com/dictionary/commercial) (last updated July 8, 2021). Commerce is defined as "the exchange or buying and selling of commodities on a large scale involving transportation from place to place." *Commerce*, Merriam-Webster.com Dictionary (www.merriam-webster.com/dictionary/commerce) (last updated July 8, 2021).

The term "business" has a similar meaning. Business is defined as "a usually commercial or mercantile activity engaged in as a means of livelihood," or "dealings or transactions especially of an economic nature." *Business*, Merriam-Webster.com Dictionary (www.merriam-webster.com/dictionary/business) (last updated July 11, 2021).

There is no dispute that the Debtor at one point, prepetition, was engaged in commercial or business activities. The UST agrees this was true when the Debtor operated its construction business. But when the business stopped operating, this activity ceased, according to the UST. The crux of the dispute then focuses on the word "activities."

Activity is defined as "the quality or state of being active: behavior or actions of a particular kind." *Activity*, Merriam-Webster.com Dictionary (www.merriam-webster.com/dictionary/activity) (last updated July 1, 2021). The clue is embedded in the word itself—an act or actions. Activities is understood then to reference one or more acts. Taken together, the phrase is a broad one intending to encompass any act of a business or commercial nature. Indeed, other courts have concluded the plain meaning of engaged in "commercial or business activities" is broad with a very inclusive range of commercial or business activity. *Ellingsworth*, 619 B.R at 521. *See also Offer Space*, 2021 WL 1582625 at *4; *In re Ikalowych*, 2021 WL 1433241 at *14. The question then is was the debtor engaged in acts of a business or commercial nature.

On the Petition Date, the Debtor's business was not operating. Still, there is no dispute that the Debtor maintained bank accounts, was working with insurance adjusters and defense counsel to resolve the Construction Claims and was engaged in efforts to sell its assets, which resulted in a sale of assets

during the bankruptcy.¹² These are all acts or actions. These acts were commercial or business in nature. They were economic in nature and the Debtor engaged in these acts with a view toward profit, or at least minimizing loss. Accordingly, these acts qualify as "commercial or business activities."

At the hearing, the parties disputed whether the Debtor was actively collecting its accounts receivable on the Petition Date. The Court did not take evidence of this issue and its determination is not necessary for the Court's ruling.

The Court rejects the UST's argument that the Debtor must have business operations to qualify as a debtor under § 1182(1)(A). The terms "activities" and "operations" are not interchangeable. See Offer Space, 2021 WL 1582625 at *4; Port Arthur Steam Energy, 2021 WL 2777993 at *4. "Operations" insinuates a fully functioning business, but "activities" encompasses acts that are business or commercial in nature but fall short of an actual operating business. This case resembles the facts in Offer Space. Even though the debtor no longer operated as it once had, by maintaining bank accounts, having accounts receivable, analyzing claims and winding down its business, the court in Offer Space held the debtor was engaged in commercial or business activities and could proceed under Subchapter V. Offer Space, 2021 WL 1582625 at *4.

*4 For the reasons stated above, the Court finds the Debtor engaged in commercial or business activities as required under § 1182(1)(A) on the Petition Date by maintaining bank accounts, working with insurance adjusters and insurance defense counsel to resolve the Construction Claims and preparing for the sale of its assets. The Court further finds that the Debtor has met its burden and is eligible to be a debtor under Subchapter V Chapter 11. Accordingly, it is,

ORDERED:

- 1. The Objection (Doc. No. 51) is **OVERRULED**.
- 2. The Debtor is eligible to proceed in this Subchapter V Chapter 11 case.

ORDERED.

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In re Vertical Mac Construction, LLC, Not Reported in B.R. Rptr. (2021)	
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In re Zhang Medical P.C., 655 B.R. 403 (2023)

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655 B.R. 403 United States Bankruptcy Court, S.D. New York.

IN RE: ZHANG MEDICAL P.C. d/b/a New Hope Fertility Clinic, Debtor.

Case No. 23-10678 (PB)

|
Signed November 30, 2023

Synopsis

Background: Debtor's landlord filed objection to designation of debtor, which operated a fertility clinic in Manhattan with an international clientele, as a small business debtor under subchapter V of Chapter 11 of the Bankruptcy Code.

Holdings: The Bankruptcy Court, Philip Bentley, J., held that:

- [1] debtor's noncontingent liquidated debts as of the petition date exceeded the \$7.5 million debt limit for subchapter V debtors set forth in the Bankruptcy Code, and
- [2] a debtor's future payment obligations under its unexpired leases and executory contracts should rarely, if ever, be counted toward the subchapter V debt limit.

Objection sustained.

West Headnotes (22)

[1] Bankruptcy • In general; nature and purpose

Congress enacted the Small Business Reorganization Act (SBRA), which, in turn, created a new subchapter, subchapter V, within Chapter 11 of the Bankruptcy Code, in order to help small businesses navigate bankruptcy more effectively. 11 U.S.C.A. §§ 1181-1195.

[2] Bankruptcy • In general; nature and purpose

Subchapter V of Chapter 11 simplifies and streamlines the reorganization process for small business in a host of ways designed to reduce the cost and length of Chapter 11 cases and to increase the prospects for a successful reorganization. 11 U.S.C.A. §§ 1181-1195.

[3] Bankruptcy → Preservation of priority Bankruptcy → Unsecured creditors and equity holders, protection of

Subchapter V of Chapter 11 makes it easier for a debtor's owners to retain ownership of the company, by eliminating the absolute priority rule in cramdown cases and, in its place, requiring the debtor to pay off its secured debt and to pay its "disposable income" to unsecured creditors for three to five years. 11 U.S.C.A. § 1191.

[4] Bankruptcy Peorganization cases

To be eligible for subchapter V of Chapter 11, the debtor must have "noncontingent liquidated" debts as of the petition date that do not exceed \$7.5 million. 11 U.S.C.A. § 1182(1)(A).

[5] Bankruptcy ← Reorganization cases

Bankruptcy ← Amount of indebtedness

Eligibility for Chapter 13, like subchapter V of
Chapter 11, is subject to a debt cap. 11 U.S.C.A.

§§ 109(e), 1182(1)(A).

[6] Bankruptcy Peorganization cases

Term "noncontingent," as used in the section of the Bankruptcy Code providing that, to be eligible for subchapter V of Chapter 11, the debtor must have "noncontingent liquidated" debts as of the petition date that do not exceed \$7.5 million, means that all of the events giving rise to liability for the debt occurred prior to the debtor's filing for bankruptcy, in contrast to a "contingent" debt, which does not become an obligation until the occurrence of a future event. 11 U.S.C.A. § 1182(1)(A).

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[7] Bankruptcy Peorganization cases

Term "liquidated," as used in the section of the Bankruptcy Code providing that, to be eligible for subchapter V of Chapter 11, the debtor must have "noncontingent liquidated" debts as of the petition date that do not exceed \$7.5 million, means that amount of the debt is easily ascertainable; in contrast, if value of claim depends on future exercise of discretion, not restricted by specific criteria, claim is "unliquidated." 11 U.S.C.A. § 1182(1)(A).

[8] Bankruptcy Peorganization cases

In assessing a debtor's eligibility for subchapter V of Chapter 11, bankruptcy court may look both to debtor's schedules and to creditors' proofs of claim in determining debtor's total noncontingent liquidated debt. 11 U.S.C.A. § 1182(1)(A).

[9] Bankruptcy Effect of proof of claim Proofs of claim are prima facie valid. Fed. R. Bankr. P. 3001(f).

[10] Bankruptcy Peorganization cases

Because debtor bears ultimate burden of proving its eligibility for subchapter V of Chapter 11, proofs of claim that debtor does not challenge may be deemed valid for subchapter V eligibility purposes. 11 U.S.C.A. § 1182(1)(A); Fed. R. Bankr. P. 3001(f).

[11] Bankruptcy Peorganization cases

Noncontingent liquidated debts scheduled by debtor, which operated a Manhattan fertility clinic with a large international clientele, or reflected in proofs of claim as of petition date substantially exceeded statutory \$7.5 million debt limit for subchapter V debtors; although debtor scheduled \$5,797,128 in noncontingent liquidated debts, 27 scheduled creditors asserted proofs of claims in amounts larger than

scheduled amounts, if those higher values were counted, resulting total would be \$10,468,441 in noncontingent liquidated debts, debtor challenged only one claim, namely, portion of landlord's claim triggered by filing of mechanic's lien, if challenged sum of \$1,338,757 were deducted from \$10,468,441 total, resulting amount of noncontingent liquidated debt, \$9,129,684, would exceed debt limit, and Bankruptcy Court's review of landlord's claim confirmed that four of its five components, that is, all but portion challenged by debtor, should be counted toward debt limit. 11 U.S.C.A. § 1182(1) (A).

[12] Bankruptcy Peorganization cases

Landlord's claim for unpaid rent was properly counted in determining whether noncontingent liquidated debts scheduled by debtor or reflected in proofs of claim as of the petition date exceeded the statutory \$7.5 million debt limit for subchapter V Chapter 11 debtors; claim was "noncontingent," since it was triggered by prepetition events, and it was "liquidated," since amount of rent was specified in parties' lease and the unpaid amount was easily calculable. 11 U.S.C.A. § 1182(1)(A).

[13] Bankruptcy Peorganization cases

Landlord's "rent credit clawback" claim was properly counted in determining whether noncontingent liquidated debts scheduled by debtor or reflected in proofs of claim as of the petition date exceeded the statutory \$7.5 million debt limit for subchapter V Chapter 11 debtors; claim, which arose from amendment to parties' lease abating debtor's obligation to pay certain rent if debtor committed no monetary default, which it later did, was "noncontingent" because it was based entirely on prepetition events, and it was "liquidated" because it was easily calculable under the lease. 11 U.S.C.A. § 1182(1)(A).

[14] Bankruptcy Peorganization cases

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Landlord's claim attributable to debtor's failure to replenish security deposit was properly counted in determining whether noncontingent liquidated debts scheduled by debtor or reflected in proofs of claim as of the petition date exceeded the statutory \$7.5 million debt limit for subchapter V Chapter 11 debtors; claim was "noncontingent" because event triggering debtor's duty to replenish deposit, namely, landlord's application of deposit to rent arrearages, occurred prepetition, and claim was "liquidated" because amount of security deposit was provided for in the lease. 11 U.S.C.A. § 1182(1)(A).

[15] Bankruptcy Peorganization cases

Portion of landlord's claim attributable to mechanic's lien, for breach of debtor's obligation to keep the leased premises free of liens, was properly excluded in determining whether noncontingent liquidated debts scheduled by debtor or reflected in proofs of claim as of the petition date exceeded the statutory \$7.5 million debt limit for subchapter V Chapter 11 debtors; Bankruptcy Court's calculation of debtor's noncontingent liquidated debts included full amount of mechanic's lienholder's claim, the portion of landlord's claim in question duplicated that amount, and so to include that portion of landlord's claim in the subchapter V debt calculation would "double count" the same debt. 11 U.S.C.A. § 1182(1)(A).

[16] Bankruptcy Peorganization cases

Landlord's claim for "other charges," including late fees, attorney fees, and interest, was properly counted in determining whether noncontingent liquidated debts scheduled by debtor or reflected in proofs of claim as of the petition date exceeded the statutory \$7.5 million debt limit for subchapter V Chapter 11 debtors; the claims were "noncontingent" and "liquidated," as each arose entirely from prepetition events, and each was readily calculable. 11 U.S.C.A. § 1182(1) (A).

[17] Bankruptcy Peorganization cases

In determining the amount of a debtor's noncontingent liquidated debts as of the petition date for purposes of eligibility under subchapter V of Chapter 11, debtor's future payment obligations under its executory contracts and unexpired leases should rarely, if ever, be included in the debt-limit calculation; until debtor elects either to assume or to reject a contract or lease, amount and nature of its obligations under that contract or lease are contingent and unliquidated, when debtor assumes a contract or lease it is doubtful, at best, whether debtor's future payment obligations should be considered "debts" for subchapter Veligibility purposes, since contract as a whole is likely a net asset, not a liability, and even when debtor rejects a contract or lease on the petition date, it may well have strong arguments that its rejection liability is contingent and/or unliquidated, such as if amount of liability is subject to factual disputes or other uncertainties. 11 U.S.C.A. §§ 365, 1182(1)(A).

[18] Bankruptcy 🕪 Executory nature in general

Under the Bankruptcy Code, an executory contract represents both an asset, namely, the debtor's right to the performance, and a liability, the debtor's own obligations to perform. 11 U.S.C.A. § 365.

[19] Bankruptcy 🕪 Executory nature in general

Unlike other debtor obligations, debtor's obligations under an executory contract or unexpired lease are part and parcel of a reciprocal agreement that involves benefits as well as burdens; in many instances, the benefits exceed the burdens, making the contract or lease a net asset, rather than a net liability, for the debtor. 11 U.S.C.A. § 365.

[20] Bankruptcy Assumption, Rejection, or Assignment

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Because some executory contracts or unexpired leases on balance are beneficial and others are detrimental to estate, the Bankruptcy Code gives debtor the option either to assume or to reject each such contract or lease. 11 U.S.C.A. § 365.

[21] Bankruptcy Effect of Acceptance or Rejection

If debtor assumes an executory contract or unexpired lease, its obligations going forward are treated on an administrative-expense basis, entitled to highest priority; if debtor rejects, counterparty's future performance obligations are excused, and counterparty is given "rejection damages" claim against debtor, that is, prepetition breach-of-contract claim, payable at same cents on dollar as other unsecured claims. 11 U.S.C.A. § 365.

[22] Bankruptcy Effect of Acceptance or Rejection

In contrast to an executory contract that is assumed by a debtor, which is an estate asset, a rejected contract is generally a pure liability to the estate, with no offsetting benefits; consequently, the debtor's rejection damages liability can fairly be considered a "debt" as the Bankruptcy Code defines that term. 26 U.S.C.A. §§ 365, 101(5)(A), 101(12).

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MODIFIED BENCH RULING GRANTING LANDLORD'S OBJECTION TO DEBTOR'S SUBCHAPTER V DESIGNATION

Hon. Philip Bentley, U.S. Bankruptcy Judge

Introduction 1

On September 8, 2023, the Court read into the record its bench ruling granting the Landlord's objection to the Debtor's subchapter V designation. This decision formalizes and expands upon the Court's bench ruling.

Zhang Medical P.C. (the "Debtor") is not a typical subchapter V debtor. The Debtor operates a fertility clinic in Manhattan with an international clientele and a reputation for employing cutting-edge techniques. The Debtor has over 90 employees and generated gross revenues of over \$27 million during the last fiscal year.

Before the Court is the objection of the Debtor's landlord, GLL BVK Columbus Circle LLC (the "Landlord"), to the Debtor's designation as a small business debtor under subchapter V of Chapter 11 of the Bankruptcy Code. The Landlord contends that the debts scheduled by the Debtor or reflected in filed proofs of claim exceed the \$7.5 million debt limit for subchapter V debtors set forth in Bankruptcy Code § 1182(1)(A). The Landlord also contends that, even if those debts did not exceed \$7.5 million, the Debtor would still be ineligible for subchapter V because the future payments it owes over the term of its lease greatly exceed \$7.5 million. For the latter argument, the Landlord relies on a recent bankruptcy court decision, In re Macedon Consulting, Inc., 652 B.R. 480 (Bankr. E.D. Va. 2023), holding that future payments owed under unexpired leases and executory contracts count toward the subchapter V debt limit.²

The Landlord advances a third argument as well: that the Court should strip the Debtor of subchapter V eligibility because of its post-petition failure to comply with multiple deadlines required of subchapter V debtors. Given its ruling on the Landlord's principal arguments, the Court need not and does not reach this issue. The Court notes that this issue has generated thoughtful but conflicting decisions by well-regarded bankruptcy judges across the country. Compare In re Free Speech Sys., LLC, 649 B.R. 729, 735 (Bankr. S.D. Tex. 2023) (Lopez, J.), and In re ComedyMX, LLC, 647 B.R. 457,

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462–64 (Bankr. D. Del. 2022) (Goldblatt, J.), with In re Nat'l Small Bus. All., Inc., 642 B.R. 345, 348–49 (Bankr. D.C. 2022) (Gunn, J.).

*407 The Court rules for the Landlord on the first of these two contentions, finding that the debts scheduled by the Debtor or reflected in proofs of claim exceed \$7.5 million. While this finding obviates the need for the Court to reach the *Macedon Consulting* issue, the Court addresses that issue nevertheless, because of the enormous—and in the Court's view detrimental—impact that ruling, if followed, would have in limiting eligibility for subchapter V relief. The Court concludes that, contrary to *Macedon Consulting*, a debtor's future payment obligations under its unexpired leases and executory contracts should rarely, if ever, be counted toward the subchapter V debt cap.

Factual Background

For more than two decades, the Debtor has operated a medical office in Manhattan, providing fertility services under the name New Hope Fertility Clinic. Its medical director and founder, Dr. John Zhang, is a recognized researcher and innovator in the field of *in vitro* fertilization and other forms of assisted reproductive technology.³ With more than 90 employees, the Debtor serves an international clientele and claims to enjoy a worldwide reputation. In the fiscal year preceding the bankruptcy, the Debtor generated gross revenues of over \$27 million.

Dr. Zhang gained international attention in 2016, when he employed a novel technique to create the world's first "three-parent baby." Working with a Jordanian couple who had lost six babies to a heritable neurological disorder, Dr. Zhang extracted the portion of the woman's DNA not linked to the disorder and inserted it into a healthy donor egg, which the woman's husband fertilized. The apparent success of this technique was widely noted.

Since 2001, the Debtor has operated out of medical offices located on Columbus Circle, which it leases from the Landlord. In 2018, anticipating the potential expansion of its business, the Debtor entered into an amended lease (the "Lease") with the Landlord, under which it leased an additional two floors in the building, doubling the amount of its leased space. The Debtor planned to sublet these two additional floors until it needed to use them, but following the onset of the COVID-19 pandemic, it was unable to do so. As a result of its inability to sublet these two floors, coupled with

other pandemic-related business strains, the Debtor fell far behind on its rent. On April 30, 2023, the Debtor commenced this case under subchapter V of chapter 11 of the Bankruptcy Code. The Debtor moved to reject the Lease two months later, and the Court granted that motion the following month.

On August 15, 2023, the Landlord filed its objection, pursuant to Rule 1020(b) of the Federal Rules of Bankruptcy Procedure, to the Debtor's designation as a subchapter V debtor (the "Objection"). The Court heard oral argument on September 7, 2023, after the completion of briefing. The facts at issue were undisputed, and the parties relied solely on the paper record. On September 8, the Court issued a bench ruling sustaining the Objection.

The Objection was filed prior to the completion of the Debtor's meeting of creditors under Bankruptcy Code § 341 and was therefore timely. See Fed. R. Bankr. P. 1020(b) (objection to subchapter V designation must be filed within 30 days after completion of § 341 meeting).

Discussion

I. General Standards Governing Eligibility for Subchapter V

[1] In 2019, to help small businesses navigate bankruptcy more effectively, Congress *408 enacted the Small Business Reorganization Act (the "SBRA"). The SBRA created a new subchapter—subchapter V—within chapter 11 of the Bankruptcy Code to address the hurdles small businesses had been facing in attempting to reorganize. *See* 11 U.S.C. §§ 1181-1195.

[3] Subchapter V simplifies and streamlines the reorganization process in a host of ways designed to reduce the cost and length of chapter 11 cases and to increase the prospects for a successful reorganization. See generally Christopher D. Hampson & Jeffrey A. Katz, The Small Business Prepack: How Subchapter V Paves the Way for Bankruptcy's Fastest Cases, 92 GEO. WASH. L. REV. (forthcoming 2024); Christopher G. Bradley, The New Small Business Bankruptcy Game: Strategies for Creditors Under the Small Business Reorganization Act, 28 AM. BANKR. INST. L.R. 251 (2020). The subchapter also makes it easier for the debtor's owners to retain ownership of the company, by eliminating the absolute priority rule in cramdown cases and, in its place, requiring the debtor to pay off its secured debt and to pay its "disposable income" to unsecured creditors for three to five years. See 11 U.S.C. § 1191.

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[4] To be eligible for subchapter V, the debtor must have "noncontingent liquidated" debts as of the petition date that do not exceed \$7.5 million. Specifically, Bankruptcy Code \$ 1182 defines an eligible debtor as "a person engaged in commercial or business activities ... that has aggregate noncontingent liquidated secured and unsecured debts, as of the date of the filing of the petition or the date of the order for relief, in an amount not more than \$7,500,000 (excluding debts owed to 1 or more affiliates or insiders)" 11 U.S.C. \$ 1182(1)(A).

[5] [6] [7] The Second Circuit Court of Appeals addressed the meaning of the terms "noncontingent" and "liquidated" at some length in *Mazzeo v. United States (In re Mazzeo)*, 131 F.3d 295 (2d Cir. 1997). That case was not a subchapter V case; instead, it arose in the analogous context of the debt limit for chapter 13 eligibility. 5 *Id.* at 298. Mazzeo was a corporate officer, whose eligibility for chapter 13 hinged on the characterization of his liability, under New York State's "responsible person" statute, for having failed to remit employee withholding taxes to the state. *Id.* at 298-99. The bankruptcy court held that Mazzeo's resulting liability was both noncontingent and liquidated, causing his total noncontingent, liquidated, unsecured debts to exceed the chapter 13 debt cap. *Id.* at 300.

Eligibility for chapter 13, like subchapter V, is subject to a debt cap. For a debtor to be eligible to proceed under chapter 13, his or her "noncontingent, liquidated, unsecured debts" may not exceed a specified amount (\$250,000 at the time *Mazzeo* was decided, but subsequently increased to \$2,750,000). *See* 11 U.S.C. § 109(e). The Court is aware of no reason why the Second Circuit's construction of the terms "noncontingent" and "liquidated" as used in § 109(e) should be any less applicable to those terms as used in § 1182(1)(A).

The Second Circuit affirmed, based on a careful review of the statutory terms "noncontingent" and "liquidated." *Id.* at 301. Starting with the first of these, the court held that the debtor's responsible-person liability was noncontingent because, under the governing statute, his obligation to pay had arisen when he failed to remit the taxes collected from the company's employees:

It is generally agreed that a debt is contingent if it does not become an obligation until the occurrence of a future event, but is noncontingent when all of the events giving rise to liability for the *409 debt occurred prior to the debtor's filing for bankruptcy.

Id. at 303 (2d Cir. 1997); *see also id.* ("A taxpayer's duty to pay taxes ... arises upon his nonpayment of the taxes when due.").

Turning to the second requirement—"liquidated"—the Second Circuit held that the debtor's statutory liability was liquidated because the amount could be easily ascertained by reference to the statute and the company's tax returns:

If the value of the claim is easily ascertainable, it is generally viewed as liquidated. If that value depends instead on a future exercise of discretion, not restricted by specific criteria, the claim is unliquidated.

Id. at 304 (internal citations and quotations omitted); see also id. (" 'courts have generally held that a debt is "liquidated" ... where the claim is determinable by reference to an agreement or by a simple computation.' ") (quoting 2 L. King, Collier on Bankruptcy ¶ 109.06[2][c] (15th ed. rev. 1997)).

[8] [9] [10] The procedural requirements for determining a debtor's total noncontingent liquidated debt are also well established. The court may look both to the debtor's schedules and to creditors' proofs of claim. See In re Hall, 650 B.R. 595, 600 (Bankr. M.D. Fla. 2023); In re Stebbins, Case No. 15-CV-1196, 2016 WL 1069077, at *4 (Bankr. E.D.N.Y. Mar. 17, 2016). Proofs of claim are prima facie valid. See Fed. R. Bankr. P. 3001(f). Because the debtor bears the ultimate burden of proving its eligibility for subchapter V, proofs of claim that the debtor does not challenge may be deemed valid for subchapter V eligibility purposes. See In re Port Arthur Steam Energy, L.P., 629 B.R. 233, 235 (Bankr. S.D. Tex. 2021).

II. The Debtor's Noncontingent Liquidated Debts as of the Petition Date Exceed \$7.5 Million

[11] Applying these principles, it is clear that the noncontingent liquidated debts scheduled by the Debtor or reflected in proofs of claim substantially exceeded \$7.5 million as of the petition date.

The Debtor scheduled \$5,797,128 in noncontingent liquidated debts as of the petition date. In addition, 27 of the scheduled creditors filed proofs of claim asserting claims in larger amounts than the Debtor had scheduled. If one adds up all the claims scheduled by the Debtor as noncontingent and liquidated and, for each claim, takes the higher of the scheduled amount or the amount stated in the proof of claim,

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the resulting total is \$10,468,441 in noncontingent liquidated debts.

At the hearing on the Landlord's Objection, the Debtor challenged only one of the filed proofs of claim—the Landlord's claim—and, in addition, objected to only one portion of that claim, namely, a \$1,338,757 charge triggered by the filing of a mechanic's lien. The Debtor did not contest the remainder of the Landlord's claim or any other proofs of claim. As a result, it is undisputed that the Debtor had at least \$9,129,684 in noncontingent liquidated debts as of the petition date (*i.e.*, \$10,468,441 minus \$1,338,757). This alone is a sufficient basis to sustain the Landlord's objection.

As a double-check on the validity of this conclusion, the Court conducted its own review of the Landlord's proof of claim, which totals \$7,007,487 and is by far the largest claim filed against the Debtor. The Landlord's claim has five components:

- 1. Unpaid rent (\$1,628.745);
- 2. A rent credit clawback (\$1,418,147);
- 3. Replenishment of the security deposit (\$2,458,665);
- *410 4. A claim arising from the filing of a mechanic's lien securing the Debtor's unpaid obligations for materials and services (\$1,338,757); and
- Other charges, including interest (\$152,344), legal fees (\$56,646), and late fees (\$3,500).

A review of these components confirms that four of the five —all but the claim relating to the mechanic's lien—should be counted toward the subchapter V debt limit.

- [12] A. <u>Unpaid rent</u>. The Landlord's claim for unpaid rent is noncontingent, under the Second Circuit's definition of that term, since it was triggered by prepetition events. *See Mazzeo*, 131 F.3d at 303. It is also liquidated, since the amount of rent is specified in the Lease and the unpaid amount is easily calculable. *See id.* at 304.
- [13] B. Rent credit clawback. The Landlord's rent credit clawback claim is also noncontingent and liquidated. This claim arose from the Second Amendment to the Lease, which abated the Debtor's obligation to pay rent for two of the leased floors for a seven-month period (January to July 2022), contingent on there being no monetary default under the Lease prior to December 31, 2024. There is no dispute that the Debtor committed a monetary default under

the Lease between the execution of the Second Amendment and the petition date. Thus, the rent credit clawback is a noncontingent claim because it is based entirely on prepetition events. It is also liquidated because it is easily calculable under the Lease.

- [14] C. Replenishment of security deposit. Similarly, the Landlord's claim attributable to the Debtor's failure to replenish the security deposit is noncontingent, because the event triggering the Debtor's duty to replenish that deposit (the Landlord's application of the deposit to rent arrearages) occurred prepetition. And the claim is liquidated, because the amount of the security deposit is provided for in the Lease.
- [15] D. Mechanic's lien. The Debtor is correct that the portion of the Landlord's claim attributable to the mechanic's lien, for breach of the Debtor's obligation to keep the leased premises free of liens, should be excluded from the debt calculation. The Court's calculation of the Debtor's noncontingent liquidated debts, discussed above, includes the full amount of the mechanic's lienholder's claim, and this portion of the Landlord's claim duplicates that amount. Consequently, to include this portion of the Landlord's claim in the subchapter V debt calculation would "double count" the same debt.
- [16] E. Other charges. The Landlord's claims for other charges—late fees, attorneys' fees and interest—are also noncontingent and liquidated. Each of these claims arose entirely from pre-petition events, and each is readily calculable.

For these reasons, the Debtor's noncontingent liquidated debts as of the petition date exceed the \$7.5 million debt limit set forth in Bankruptcy Code § 1182(1)(A), and the Debtor is ineligible to proceed under subchapter V.

III. A Debtor's Future Payment Obligations Under Executory Contracts and Unexpired Leases Should Rarely, if Ever, Be Included in the Subchapter V Debt Limit Calculation

[17] As an alternate basis for its objection to the Debtor's subchapter V designation, the Landlord asks the Court to follow a recent decision by a bankruptcy court in Virginia, holding that, in determining the amount of a debtor's noncontingent liquidated *411 debts for subchapter V eligibility purposes, courts should include the debtor's future payment obligations under its executory contracts and

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unexpired leases. In re Macedon Consulting, Inc., 652 B.R. 480, 485-86 (Bankr. E.D. Va. 2023).

The debtor in Macedon Consulting was a software developer that, like the Debtor here, had fallen on hard times and, as a result of the COVID-19 pandemic, needed less office space than it had previously leased. Id. at 482. Unlike the Debtor here, Macedon Consulting moved on the petition date to reject its unexpired office leases. Id. at 484. The debtor's two landlords moved to dismiss the bankruptcy, and alternatively asked the court to revoke the debtor's subchapter V designation on the ground that its future rent under the leases exceeded \$14 million. Id. Applying essentially the same definition of noncontingent debt that the Second Circuit applied in *Mazzeo*, the court held that the debtor's future rent obligations were noncontingent, because the debtor's liability for all rent over the term of the leases "arose pre-petition, on the dates the Leases were fully executed." Id. at 485 (quoting In re Parking Mgmt., 620 B.R. 544, 556 (Bankr. D. Md. 2020)).6

The court did not base its decision on the unusual fact that the debtor had moved on the petition date, rather than on a later date, to reject its leases, even though this fact arguably could have provided a sounder basis for the court's conclusion that the debtor's lease liability was noncontingent on the petition date. See infra, fn. 8.

If this ruling were followed, it would greatly restrict subchapter V eligibility, since many debtors otherwise eligible for that subchapter are parties to long-term leases or contracts with future payment obligations well in excess of \$7.5 million. In this case, for example, the Debtor's future base rent payments under the Lease exceed \$60 million.

[18] [19] The Court declines to follow Macedon Consulting. In the Court's view, that decision overlooks the distinctive nature of a debtor's obligations under its executory contracts and unexpired leases, which differ in key respects from other debtor obligations. As the Supreme Court has observed, an executory contract "represents both an asset (the debtor's right to the performance) and a liability (the debtor's own obligations to perform)." Mission Product Holdings, Inc. v. Tempnology, LLC, — U.S. —, 139 S. Ct. 1652, 1658, 203 L.Ed.2d 876 (2019). That is, a debtor's obligations under an executory contract or unexpired lease are part and parcel of a reciprocal agreement that involves benefits as well as burdens. In many instances, the benefits exceed the burdens, making the contract or lease a net asset, rather than a net liability, for the debtor.

[20] [21] Because some executory contracts or unexpired leases on balance are beneficial and others are detrimental to the estate, the Bankruptcy Code gives the debtor the option either to assume or to reject each such contract or lease. See Code § 365(a); see generally In re Orion Pictures Corp., 4 F.3d 1095, 1098-99 (2d Cir. 1993) (court should approve assumption or rejection if debtor, in its reasonable business judgment, has determined that to be in the estate's best interest). If the debtor assumes a contract or lease, its obligations going forward are treated on an administrative expense basis, entitled to the highest priority. If the debtor rejects, the counterparty's future performance obligations are excused, and the counterparty is given a "rejection damages" claim against the debtor—that is, a pre-petition breach of contract claim, payable at the same cents on the dollar as other unsecured claims. See id. at 1098. For rejected leases, the debtor's liability is further limited *412 by the statutory cap provided by Bankruptcy Code § 502(b)(6).

Several conclusions follow from this. First, when a debtor assumes an executory contract or unexpired lease, it is doubtful, at best, whether the debtor's future payment obligations under that contract or lease should even be considered "debts" for purposes of subchapter V's eligibility formula. As just noted, a debtor may not assume a contract or lease unless it reasonably determines this is in the estate's best interest—that is, that the contract or lease is a net asset. *Id.* at 1098-99. To consider the assumed obligations in isolation and treat them as debts would ignore that the contract as a whole is an asset, not a liability.

Second, until the debtor elects either to assume or to reject an executory contract or unexpired lease, the amount and nature of its obligations under that contract or lease are contingent and unliquidated. If it assumes, it will be responsible to pay all contractual obligations in hundred-cent dollars. But if it rejects, its obligations will be payable on a pre-petition basis, and the amount of those obligations will usually be much smaller—for contracts, the amount of damages caused by the debtor's breach, and for leases, the capped amount set by Code § 502(b)(6). Because the amount and nature of the debtor's obligations, as well as whether these are even "debts," depend on an uncertain future event-the debtor's election to either assume or reject—any eventual debt is both contingent and unliquidated prior to that election. See Mazzeo, 131 F.3d at 303; see also 11 U.S.C. § 1182(1)(A) (only debts that are noncontingent and liquidated "as of the date of the filing of the petition" are counted toward the subchapter V debt cap).

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[22] If a debtor were to reject a contract or lease on the petition date, it could be argued that the debtor's rejection damages liability is a noncontingent debt as of that date for purposes of the subchapter V debt limit. However, such a circumstance is relatively rare, since the decision to assume or reject often turns on post-petition developments, such as negotiations with the landlord or contract counterparty, the development of a plan of reorganization, or (if the business is sold) the buyer's plans. And even a debtor that rejects a contract or lease on the petition date may well have strong arguments that its rejection liability is contingent and/or unliquidated. For example, at least one court has held that a debtor's rejection liability is contingent, for subchapter V eligibility purposes, until the court approves the debtor's decision to reject rather than assume. See Parking Management, 620 B.R. at 553-54. In addition, a debtor's rejection liability may be unliquidated, if the amount of liability is subject to factual disputes or other uncertainties that make it not readily calculable.8

- In contrast to an assumed contract, which is an estate asset, a rejected contract is generally a pure liability to the estate, with no offsetting benefits. Consequently, the debtor's rejection damages liability can fairly be considered a "debt," as the Bankruptcy Code defines that term. See Code § 101(12) (" 'debt' means liability on a claim"); § 101(5)(A) (" 'claim' means right to payment, whether or not such right is ... liquidated, unliquidated, fixed [or] contingent ...").
- In *Macedon Consulting*, the debtor moved to reject its leases on the petition date, *see* 652 B.R. at 484, but the court did not base its decision on this fact and, as a result,

did not address these issues. Curiously, the court did not hold that the debtor's petition-date motion made its rejection damages liability noncontingent by eliminating any uncertainty as to whether it would reject. Instead, the court treated the debtor's rejection as a contingent postpetition event that it should not consider. *See id.* at 485 ("post-petition events should not be used to determine eligibility for subchapter V.") On this ground, the court computed the debtor's debt under its rejected leases as the total amount of all future rent, rather than the capped rent amount specified by Bankruptcy Code § 502(b)(6). *Id.* at 485-486.

*413 In the present case, the Debtor did not reject the Lease on the petition date, but instead spent several months in post-petition negotiations with the Landlord before finally moving to reject. Consequently, the Court need not reach the issues just discussed, and the Court expresses no view on those issues. Because the Debtor did not move to reject the Lease until after the petition date, its eventual liability under the Lease was contingent and unliquidated as of that date. That liability therefore is not properly counted toward the subchapter V debt cap.

Conclusion

The Debtor's noncontingent liquidated debts as of the petition date exceed the \$7.5 million debt limit set forth in Bankruptcy Code § 1182(1)(A), and the Debtor therefore is ineligible to proceed under subchapter V.

All Citations

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United States Court of Appeals, Eleventh Circuit.

PRN REAL ESTATE & INVESTMENTS,

LTD., Plaintiff-Appellant,

V.

William W. COLE, Jr., Defendant-Appellee.

No. 22-11118

Filed: 11/02/2023

Synopsis

Background: Creditor filed adversary complaint seeking to determine nondischargeability of debts and to deny debtor's Chapter 7 discharge. The Bankruptcy Court granted debtor summary judgment on claim to except from discharge portion of \$4 million transfer from nonexempt limited partnership to exempt "tenancy by the entireties" account. After trial on remaining claims, the United States Bankruptcy Court for the Middle District of Florida, No. 6:15-ap-00168-KSJ, Karen S. Jennemann, J., 2021 WL 784886, entered judgment in favor of debtor. Creditor appealed, and the United States District Court for the Middle District of Florida, No. 6:21-cv-711-WWB, Wendy W. Berger, J., 2022 WL 1096091, affirmed. Creditor appealed again.

Holdings: The Court of Appeals, Corey L. Maze, District Judge, sitting by designation, held that:

- [1] creditor failed to show that debtor concealed the value of his lakefront property, as would have warranted denial of discharge, by splitting it into two parcels;
- [2] creditor failed to show that debtor concealed property when he did not label his advances to business owned by debtor and his spouse as a shareholder loan;
- [3] creditor failed to plead with requisite particularity claim to deny debtor's discharge based on "false oaths" related to his homestead;
- [4] Bankruptcy Court did not clearly err in finding that debtor did not make a "false oath" when he omitted limited partnership from his list of businesses;

- [5] creditor pleaded viable claim to except debt from discharge on "actual fraud" theory; and
- [6] trustee's action to avoid \$4 million transfer did not preempt creditor's claim to except debt from discharge on "actual fraud" theory.

Affirmed in part, reversed in part, and remanded.

West Headnotes (27)

[1] Bankruptcy 🧼 Scope of review in general

When district court affirms bankruptcy court's order, Court of Appeals, acting as a second court of review, considers bankruptcy court's decision directly.

[2] Bankruptcy — Conclusions of law; de novo review

Court of Appeals reviews bankruptcy court's entry of summary judgment de novo, viewing all evidence in the light most favorable to the nonmoving party, and resolving reasonable inferences in nonmovant's favor.

[3] Bankruptcy Conclusions of law; de novo review

Court of Appeals reviews the bankruptcy court's conclusions of law de novo.

[4] Bankruptcy 🤛 Clear error

Court of Appeals reviews the bankruptcy court's findings of fact for clear error.

[5] Bankruptcy Pauline Questions of law or fact

On appeal in bankruptcy proceeding, how the Court of Appeals reviews a mixed question of law and fact depends on whether answering it entails primarily legal or factual work; review is de novo when Court of Appeals must expound on the law, particularly by amplifying or elaborating

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on a broad legal standard, but review is for clear error when Court of Appeals must marshal and weigh evidence, make credibility judgments, and otherwise address multifarious, fleeting, special, narrow facts that utterly resist generalization.

[6] Bankruptcy 🕪 Discretion

Court of Appeals reviews the bankruptcy court's evidentiary rulings for abuse of discretion.

[7] Bankruptcy Mature of property; debtor's interest

Creditor failed to show that Chapter 7 debtor concealed the value of his lakefront property, as would have warranted denial of discharge, by splitting it into two parcels less than two months before filing his bankruptcy petition; creditor presented no facts that show that debtor knowingly withheld information related to the property or acted to prevent the discovery of the property, to the contrary, debtor publicly recorded both deeds and continued to pay taxes on the whole property, and after debtor filed his petition, debtor told the trustee about the split and listed both parcels in his schedules. 11 U.S.C.A. § 727(a)(2)(A).

1 Case that cites this headnote

[8] Bankruptcy ← Nature of property; debtor's interest

Creditor failed to show that Chapter 7 debtor concealed property after this bankruptcy case was filed, as would have warranted denial of discharge, when he did not label his advances to business owned by debtor and his spouse as a shareholder loan; debtor believed that he was making equitable contributions rather than loans to business, and debtor did not conceal information from trustee, but rather, cooperated with her when she had questions about "loan versus equity" issue. 11 U.S.C.A. § 727(a)(2)(B).

[9] Bankruptcy Nature of property; debtor's interest

Creditor failed to show that Chapter 7 debtor omitted limited partnership from his list of businesses with the intent to hinder, delay, or defraud creditors or trustee, as would have warranted denial of discharge, where business was listed in a different part of debtor's schedules, and debtor promptly disclosed business's financial records once the omission was discovered. 11 U.S.C.A. § 727(a)(2)(B).

1 Case that cites this headnote

[10] Bankruptcy 🕪 Findings of Fact

In reviewing bankruptcy court's decision, Court of Appeals generally defers to the trier of fact's credibility determination because the fact finder heard the witness's testimony and saw his demeanor, while the Court of Appeals is stuck with a cold paper record.

[11] Bankruptcy False Oath or Account

Debtor can make a "false oath," of kind that may warrant denial of discharge, in his petition, in his schedules, at creditor meetings, and when giving sworn testimony. 11 U.S.C.A. § 727(a)(4).

[12] Bankruptcy 🕪 False Oath or Account

"False oath," of kind that may warrant denial of discharge, must be fraudulent and material. 11 U.S.C.A. § 727(a)(4).

[13] Bankruptcy Pleading

Creditor failed to plead with requisite particularity claim to deny debtor's Chapter 7 discharge based on "false oaths" related to his homestead by alleging debtor knowingly and fraudulently made multiple false oaths and accounts, including failing to include all assets in his schedules and statement of financial affairs while testifying under oath they were accurate and failing to provide accurate information with respect to his income, without mentioning debtor's homestead. 11 U.S.C.A. § 727(a)(4); Fed. R. Civ. P. 9(b); Fed. R. Bankr. P. 7009.

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[14] Bankruptcy 🕪 Pleading

Bankruptcy Court did not err refusing to amend creditor's adversary complaint after trial to add a homestead-based false oath claim to deny debtor's Chapter 7 discharge; debtor did not expressly consent to amendment, but rather, he objected to it, and Court found that it would be unfair and prejudicial to allow creditor to fix its pleading deficiency after the Court took evidence and issued its preliminary opinion. 11 U.S.C.A. § 727(a)(4); Fed. R. Civ. P. 15(b); Fed. R. Bankr. P. 7015.

[15] Bankruptcy Pleading; dismissal

Implied consent to try an unpleaded issue will not be found if the defendant had no notice of the new issue, if the defendant could have offered additional evidence in defense, or if the defendant in some other way was denied a fair opportunity to defend. Fed. R. Civ. P. 15(b); Fed. R. Bankr. P. 7015.

[16] Bankruptcy Ferrors on and omissions from schedules

Bankruptcy Court did not clearly err in finding that Chapter 7 debtor did not make a "false oath," of kind that may warrant denial of discharge, when he listed his property as two parcels in his schedule, because at the time the property was legally divided into two parcels, and debtor's attorney told the trustee about the division before debtor filed his schedules. 11 U.S.C.A. § 727(a) (4).

[17] Bankruptcy • Oath or account as to property or indebtedness

Bankruptcy Court did not clearly err in finding that Chapter 7 debtor did not make a "false oath," of kind that may warrant denial of discharge, when he testified that he divided property into two parcels because he believed the state of Florida owned submerged portion of property; both debtor and creditor seeking denial of

discharge presented reasoned arguments, and the issue was complex. 11 U.S.C.A. § 727(a)(4).

[18] Bankruptcy Firors on and omissions from schedules

Bankruptcy Court did not clearly err in finding that Chapter 7 debtor did not make a "false oath," of kind that may warrant denial of discharge, when he did not label his \$1 million in advances to business owned by debtor and his spouse as a shareholder loan; Bankruptcy Court found that debtor honestly believed that the advances were capital contributions, meaning that he had no fraudulent intent when he did not list the advances as shareholder loans. 11 U.S.C.A. § 727(a)(4).

[19] Bankruptcy Errors on and omissions from schedules

Bankruptey Court did not clearly err in finding that Chapter 7 debtor did not make a "false oath," of kind that may warrant denial of discharge, when he omitted limited partnership from his list of businesses; debtor's omission of business was inadvertent, not intentional. 11 U.S.C.A. § 727(a) (4).

[20] Bankruptcy • Use of money or property obtained

Discharge exception for debt for money to the extent obtained by actual fraud turns on how the money was obtained; if debtor obtained money by actual fraud, then any debts traceable to the fraudulent conveyance will be nondischargeable. 11 U.S.C.A. § 523(a)(2)(A).

[21] Bankruptcy • Obtaining money, property, or service

Bankruptcy • Use of money or property obtained

To except debt under fraud discharge exception, creditor must show that (1) debtor obtained money, property, or services by actual fraud, and,

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(2) the debt to be excepted resulted from the debtor's fraudulent receipt. 11 U.S.C.A. § 523(a) (2)(A).

[22] Bankruptcy • Obtaining money, property, or service

Fraud discharge exception can only apply to the recipient of a fraudulent transfer because the transferor did not "obtain" money, property, or services, and his debt necessarily resulted from an earlier event. 11 U.S.C.A. § 523(a)(2)(A).

[23] Bankruptcy Fraud committed by agent or one other than debtor

As long as fraud was involved when debtor obtained assets, debtor need not be party who committed fraud for Bankruptcy Code's exception to discharge to apply.

[24] Bankruptcy 🤛 Fraud

Creditor pleaded viable claim to except debt from discharge on "actual fraud" theory by alleging that Chapter 7 debtor fraudulently transferred money from nonexempt limited partnership to exempt "tenancy by the entireties" account to hinder creditor's claim for the money, and that, under state law, debtor took on limited partnership's contribution debt to creditor when he fraudulently obtained its money. 11 U.S.C.A. § 523(a)(2)(A).

[25] Bankruptcy • Obtaining money, property, or service

Party who fraudulently transfers money to avoid paying existing debt is not subject to fraud discharge exception because that party did not "obtain" money by fraud and his preexisting debt is not traceable to fraudulent transfer. 11 U.S.C.A. § 523(a)(2)(A).

[26] Bankruptcy Fraudulent conveyances in general

Bankruptcy Frustee as representative of debtor or creditors

Bankruptcy • Use of money or property obtained

Chapter 7 trustee's action to avoid \$4 million transfer from nonexempt limited partnership to exempt "tenancy by the entireties" account and recover debtor's interest in the money did not preempt creditor's claim to except debt from discharge on "actual fraud" theory, alleging that debtor caused limited partnership to transfer the money to hinder creditor's claim for the money, and as a result, under state law, debtor took on limited partnership's contribution debt to creditor; no Bankruptcy Code provision extinguished a creditor's right to seek a discharge exception because trustee sought to avoid a fraudulent transfer or the full denial of discharge, nor did it appear that Congress intended trustees to have exclusive authority to press claims based on fraudulent transfers. 11 U.S.C.A. §§ 523(a)(2) (A), 544(b)(1), 550(a)(1), 727(a).

[27] Statutes Presumptions

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

*1327 Appeal from the United States District Court for the Middle District of Florida, D.C. Docket No. 6:21-cv-711-WWB

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Before Jill Pryor and Grant, Circuit Judges, and Maze, District Judge.

* Honorable Corey L. Maze, United States District Judge for the Northern District of Alabama, sitting by designation.

Opinion

Maze, District Judge:

*1328 William W. ("Bill") Cole, Jr., petitioned for Chapter 7 bankruptcy and listed PRN Real Estate & Investments, Ltd. ("PRN") as his primary creditor. PRN sought to exempt debts that Cole owes PRN from being discharged. The bankruptcy court granted judgment for Cole on all of PRN's claims and fully discharged Cole's debt. The district court affirmed.

For the reasons explained below, we agree with each of the bankruptcy court's rulings except one: we find that PRN pleaded a viable discharge exception in Count 3. We therefore AFFIRM IN PART and REVERSE IN PART the bankruptcy court's rulings and REMAND for further proceedings.

I. BACKGROUND

Bill Cole and Nancy Rossman partnered to develop residential real estate for more than a decade. But their relationship has since devolved into what the bankruptcy court described as "open warfare." In short, Rossman claims that Cole sought bankruptcy to avoid paying the \$15-plus million debt he owed Rossman's company, PRN. She also claims that Cole committed multiple acts of fraud to place his assets out of PRN's reach. The resulting fight has spilled across multiple state and federal courts, returning now to us for a second time.

A. Cole's Debt to PRN

Bill Cole has worn many hats: accountant, CFO, and real estate developer. As a developer, Cole would identify lucrative projects, then find investors and builders. Cole managed the projects on both ends, funding and construction. Some projects he managed through entities that he created for the project; others he managed with his partner, Allan

Goldberg, through their joint business, C&G Real Estate Group, LLC ("C&G").

Nancy Rossman and her sisters owned PRN. PRN pumped millions of dollars into C&G projects starting in 2000. For the next eight years, Rossman's relationship with Cole was amicable and financially successful. Then the recession hit.

In 2008, Cole's projects were struggling. So PRN agreed to lend extra capital to Cole. In return, Cole agreed to personally guarantee the loans. But Cole could not repay the loans when they came due in November 2011.

So Cole and Rossman amended their 2008 agreement in 2012. Among the amended terms, Cole agreed to cut his partner Allan Goldberg out of the projects. Cole agreed to continue old projects that included PRN and to allow PRN to invest in Cole's new projects. And Cole agreed that he would pay a percentage of his project income to PRN and provide detailed financial reports to PRN to ensure Cole was upholding his end of the bargain.

*1329 Cole eventually breached his duties under the 2012 Agreement. Rossman and PRN filed their first lawsuit against Cole in Florida state court in July 2014. One year later, Cole filed for Chapter 7 bankruptcy. That petition is now before this Court. But before we can discuss Cole's petition, we must detail some of Cole's actions leading up to its filing.

B. Alleged Fraud

PRN claims that Cole committed several fraudulent acts to shield his money from PRN before and after Cole filed his Chapter 7 petition. Three are relevant here.

1. The COLP Transfers

In 2002, Bill Cole and his wife Terre formed Cole of Orlando Limited Partnership ("COLP"), a Nevada entity, to hold their investments. Each spouse owned a 49.5% interest in COLP through his or her respective revocable trusts. The remaining 1% was held by W&T Cole, LLP, another Nevada entity that the Coles owned as tenants by the entireties.

Over the years, COLP held stocks, bonds, and brokerage accounts. Relevant here, COLP also incurred debts related to projects involving Cole and PRN.

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In 2003, SunTrust Bank loaned \$7.5 million to Douglasville Development, LLC and Sweetwater Investment Properties, LLC. Thirteen individuals and entities jointly and severally guaranteed the loan, including Bill Cole, Terre Cole, Rossman, Goldberg, PRN, and COLP.

In August 2004, SunTrust Bank loaned \$1.21 million to RANC Development, Inc. Ten individuals and entities jointly and severally guaranteed the loan, including Bill Cole, Terre Cole, Rossman, Goldberg, PRN, and COLP.

Both Douglasville and RANC defaulted on their loans, making the co-guarantors jointly and severally liable to SunTrust. In September 2011, PRN agreed to pay SunTrust \$5 million to settle these and other debts. None of the co-guarantors paid PRN contribution.

Two months later (November 2011), Cole's debt to PRN under their 2008 agreement matured. PRN notified Cole of his default on December 15, 2011. At the time, Cole owed PRN more than \$12 million.

Over the next four weeks, Cole transferred about \$4 million from COLP's coffers into a Florida-based account held by Bill and Terre Cole as tenants by the entireties, thereby shielding the money from Cole's creditors under Florida law. The COLP transfers are relevant in two proceedings besides this one.

First, PRN sued its co-guarantors under the Douglasville and RANC notes for contribution in Florida state court. *See PRN Real Est. & Invs., Ltd. v. Cole*, Fla. Orange County Ct., Case No. 2014-CA-011835-O. PRN named COLP and Bill Cole (among others) as defendants. PRN sought the following contribution from COLP: \$213,113.71 as co-guarantor of the Douglasville Note and \$187,121.46 as co-guarantor of the RANC Note.

Second, the Bankruptcy Trustee sought to avoid the COLP transfer as a fraudulent conversion of non-exempt assets into exempt assets and to retrieve Cole's personal interest for the estate. See 11 U.S.C. § 544(b)(1) (allowing the Trustee to avoid transfers under applicable state law); 11 U.S.C. § 550(a) (allowing the Trustee to recover fraudulent transfers for the estate). The bankruptcy court granted summary judgment for the Trustee by finding that Cole controlled the transfers, and that Cole transferred the money "actually intending to hinder, delay, and defraud his creditors, primarily PRN."

*1330 The bankruptcy court did not quantify Cole's personal interest in the COLP transfers, leaving that issue for trial. But Cole and the Trustee settled the claim before trial. Under the settlement agreement, Cole paid \$350,000 to the estate and agreed that his settlement with the Trustee did not affect PRN's claims in this case and the previously mentioned state case.

2. Coledev

In October 2012, Cole formed Coledev LLC to serve as his primary operating business. Coledev was a closely held S corporation. Bill and Terre Cole owned 99% of Coledev as tenants by the entireties, with their son owning the remaining 1%

Shortly after forming Coledev, Bill and Terre Cole transferred about \$1.18 million to Coledev to fund operations. Money flowed freely between the Coles and Coledev for the next three years. Then, shortly after Bill Cole filed his bankruptcy petition in July 2015, Coledev transferred \$750,000 to a construction business primarily owned (95%) by Terre Cole, and about \$250,000 to the Coles' joint bank account.

Cole's Trustee argued that Coledev's postpetition transfer was a repayment of a shareholder loan that Cole must turn over to the estate under 11 U.S.C. § 542. Cole countered that the Coles' initial \$1.18 million transfer to Coledev was an equitable contribution and thus Coledev was repaying a capital contribution; a payment that needn't be turned over to the estate.

The bankruptcy court sided with Cole, finding that the initial 2012 transfer of money to Coledev was a capital contribution (not a loan), so the 2015 transfer of money out of Coledev was an equity repayment. The court thus issued judgment that the \$1 million transfer need not be turned over to the estate.

The Trustee appealed but later waived the appeal as part of the previously mentioned settlement that saw Cole pay \$350,000 to the estate.

3. Homestead Fraud

When Cole filed his petition in July 2015, Bill and Terre Cole lived in a 10,000 square foot lakefront home. Cole held title to the property under a self-settled revocable trust. Cole's original title listed the property as a single 2.95-acre parcel of land, with most of the land (2.185 acres) under water.

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The Florida Constitution exempts a debtor's homestead from forced sale after bankruptcy but limits the exemption to 0.5 acres if the homestead is within a municipality. *See* Fla. Const. art. X, § 4. Because Cole's 2.95-acre property was in a municipality, it was too big for the exemption. So Cole split the property.

Two days after a failed mediation with Rossman, Cole asked a surveyor to divide his property into two parcels. The first contained the house, boathouse, and dock. The second parcel contained everything else, including all of the submerged land. Just before filing his bankruptcy petition, Cole executed and recorded special warranty deeds that conveyed the newly split parcels from the trust to the trust.

Cole filed his petition, and soon after, his schedules. In them, Cole listed the two parcels separately. Cole gave the street address for the smaller, dry-land parcel and valued it at \$2.5 million. Cole generically labeled the larger, mostly submerged parcel and valued it at \$1,000. Cole did not state the size of either parcel in his schedules, nor did he list them as contiguous.

Both PRN and the Trustee objected, claiming that Cole fraudulently split his property to shield the valuable portion from the estate. The bankruptcy court held *1331 a two-day trial then issued a written opinion. In it, the court found that Cole's schedules were "misleading" and that his testimony explaining the split was "not credible."

Yet "[d]espite Mr. Cole's inequitable and incredulous attempt to gerrymander his homestead exemption," the bankruptcy court found that Florida law required the court to grant Cole the homestead exemption. To undo the fraud, the court treated the property as indivisible and held that Cole was entitled to 16.95% of the forced sale of the whole—*i.e.*, the 0.5-acre homestead exemption limit divided by the entire 2.95-acre parcel.

The district court affirmed, as did this Court. See Cole v. PRN Real Est. & Invs., Ltd., 829 Fed. App'x 399 (11th Cir. 2020).

C. The Bankruptcy Court's Opinions

Cole filed his Chapter 7 petition and listed PRN (among others) as a creditor. PRN filed an adversary proceeding. *See* Fed. R. Bankr. P. 7001. In its operative complaint, PRN pleaded 13 counts that sought to deny Cole a discharge under

11 U.S.C. § 727, or in the alternative, to except certain debts from discharge under 11 U.S.C. § 523. In this appeal, only Counts 3-4, 8-9, and 11 matter. So we do not discuss the other counts.

1. Counts 3-4 sought to exempt from discharge some portion of the \$4 million transfer from COLP to the Coles' tenancy by the entireties ("TBE") account—*i.e.*, the transfer the bankruptcy court found fraudulent under Florida law at the Trustee's behest. The bankruptcy court granted Cole summary judgment on these claims, ruling orally that "I believe that PRN is asking for a cause of action that just isn't there, and to the extent that it ever could be there, it would belong to the Trustee."

The Honorable Cynthia Jackson held a trial on all other counts in October 2018. Judge Jackson, however, could not issue a posttrial opinion because of medical concerns. The case was thus reassigned to the Honorable Karen S. Jennemann, who recalled Cole and the Trustee to testify in October 2020. Judge Jennemann later granted judgment for Cole on all remaining counts.

2. Counts 8 and 9 sought a complete denial of discharge under 11 U.S.C. §§ 727(a)(2)(A) and 727(a)(2) (B), respectively. Relevant here, PRN argued that Cole fraudulently concealed the splitting of his homestead into two parcels and fraudulently concealed the assets he received from Coledev by mislabeling his initial contributions as equity rather than shareholder loans.

As for the Coles' homestead, the bankruptcy court reiterated its earlier ruling that Cole knowingly manipulated the parcels to shield his home from becoming part of the estate. Still, the court found that Cole had not "concealed" either parcel from the Trustee, as required by § 727(a)(2), because Cole (1) listed both parcels in his schedules and (2) told the Trustee about the division when Cole first met her. The court also noted that, after its earlier ruling that unified the parcels, the property sold for \$2.25 million—nearly the same amount Cole estimated (\$2.5 million). So the estate had not been harmed by Cole's misconduct.

As for Coledev, the court noted that "all parties knew of [Cole's] ownership interest" in Coledev because Cole listed it in his schedules. The court found the disagreement over labeling Cole's contributions as equity versus loans to "make[] no difference" when it came to concealment because those labels "are often meaningless" when it comes

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to closely held corporations. Plus, the Trustee knew about the distinction *1332 early on and confirmed that "Cole was cooperative and supplied all the information and documents she requested." So the court could not find that Cole concealed his Coledev-related assets with an intent to hinder, delay, or defraud his creditors or the Trustee under § 727(a)

3. Count 11 alleged that Cole knowingly made a false oath under 11 U.S.C. § 727(a)(4) by concealing the value of Coledev and failing to list COLP in his schedules. After trial, PRN added that Cole made multiple false oaths about dividing his homestead.

As for Coledev, PRN complained that Cole listed its value as "undetermined," even though Cole told a bank that Coledev was valued at \$3.985 million just days before filing his petition. Cole testified that the \$3.985 million figure was his estimate about the amount of money the Coles had given Coledev, not its value as a going business concern. Cole testified that the latter value would be difficult to calculate and drastically different. The bankruptcy court found this testimony "credible and convincing" and thus held that Cole's oath was not false.

As for COLP and its 1% partner, W&T Cole LLC, the bankruptcy court found that Cole's omission of COLP from his Statement of Financial Affairs ("SOFA") was material. But the court found credible Cole's testimony that he inadvertently omitted COLP from his SOFA, particularly because Cole disclosed COLP as a co-obligor in his Schedule H and disclosed a COLP account that had funds during his 341 meeting. Further, Cole provided the Trustee with information about COLP once the omission was noticed, and the Trustee testified that the omission did not affect her administration of the estate.

Finally, the bankruptcy court found that PRN had not pleaded a false oath claim about the Coles' homestead in its third amended complaint, nor had PRN mentioned the claim in its pretrial statement or posttrial brief. In the alternative, the court also found that Cole had not made a false oath about his property.

Having ruled for Cole on all counts, the bankruptcy court found that Cole's debts should be discharged.

D. The District Court Appeal

PRN appealed to the district court. *See* 28 U.S.C. § 158(a) (1) (giving district courts jurisdiction over appeals from a bankruptcy court's final order). The district court affirmed the bankruptcy court's posttrial rulings on Counts 8, 9, and 11 on the same grounds found by the bankruptcy court. Because this Court directly considers the bankruptcy court's opinion, rather than the district court's opinion, *see In re Hoffman*, 22 F.4th 1341, 1344 (11th Cir. 2022), we do not recount the district court's reasons for affirming the bankruptcy court's rulings on Counts 8, 9, and 11.

We do, however, dive deeper into the district court's opinion on Counts 3 and 4 because the district court offered more grounds than the bankruptcy court's oral ruling. As for Count 3, the district court found that PRN pleaded that Cole was "liable as the transferor" of the \$4 million, and PRN had not alleged "a basis to impute a new debt to Cole as transferor." According to the district court, "as alleged, Count III would only provide liability against Cole for the preexisting debts of Cole of Orlando—which no one argues were obtained by fraud." The court further found that Florida law did not provide a cause of action to recover compensatory damages against the recipient of a fraudulent transfer, only "a vehicle for the equitable recovery of assets, a claim that PRN concedes is typically within the exclusive standing of the trustee."

*1333 The district court found that PRN abandoned Counts 4-6 on appeal because PRN inadequately briefed standing, the issue PRN lost in the bankruptcy court. Alternatively, the court held that PRN failed to meet its burden of proving that creditor standing could exist beyond the "[T]rustee's exclusive standing to ... avoid fraudulent transfers." Like the bankruptcy court, the district court held that "the proper 'creditor' to bring such a claim is the trustee because, in the context of bankruptcy, the trustee has the exclusive right to seek to avoid the transfers and return the sums to the estate."

PRN now appeals to this Court.

II. STANDARD OF REVIEW

[1] We act as the second court of review in this bankruptcy appeal. Because the district court affirmed the bankruptcy

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court on all counts, we consider the bankruptcy court's decision directly. *In re Hoffman*, 22 F.4th at 1344.

- [2] We review the bankruptcy court's entry of summary judgment on Counts 3-6 *de novo*, viewing all evidence in the light most favorable to PRN as the non-moving party, and we resolve reasonable inferences in PRN's favor. *In re Optical Techs.*, *Inc.*, 246 F.3d 1332, 1334-35 (11th Cir. 2001).
- [4] [5] [6] As for the counts that went to trial, we review the bankruptcy court's conclusions of law de novo. In re Colortex Indus., Inc., 19 F.3d 1371, 1374 (11th Cir. 1994); In re Vann, 67 F.3d 277, 280 (11th Cir. 1995). We review the bankruptcy court's findings of fact for clear error. In re Chase & Sanborn Corp., 904 F.2d 588, 593 (11th Cir. 1990). How we review a mixed question of law and fact "depends on whether answering it entails primarily legal or factual work." In re Stanford, 17 F.4th 116, 121 (11th Cir. 2021) (quotation omitted). Our review is de novo when we must "expound on the law, particularly by amplifying or elaborating on a broad legal standard." Id. (quotation omitted). But our review is for clear error when we must "marshal and weigh evidence, make credibility judgments, and otherwise address ... multifarious, fleeting, special, narrow facts that utterly resist generalization." Id. (alteration in original) (quotations omitted). Finally, we review the bankruptcy court's evidentiary rulings for abuse of discretion. See In re Int'l Mgmt. Assocs., LLC, 781 F.3d 1262, 1265 (11th Cir. 2015).

III. DISCUSSION

As a Chapter 7 debtor, Cole is entitled to a discharge of all debts unless his Trustee, a creditor, or the United States trustee establishes either (1) one of the twelve reasons to deny a discharge listed in 11 U.S.C. § 727(a) or (2) that one or more of Cole's debts should be individually excepted under 11 U.S.C. § 523(a). See 11 U.S.C. § 727(b) ("Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter").

PRN pleaded counts under § 727(a) and § 523(a). Because success under § 727(a) would prevent Cole from discharging any debts—thereby obviating the need to except individual debts under § 523(a)—we start by reviewing PRN's § 727(a) claims.

A. Concealment of Property (§ 727(a)(2))

Section 727(a)(2)¹ prohibits the bankruptcy court from granting a discharge if

- *1334 (2) 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—
- (A) property of the debtor, within one year before the date of the filing of the petition; or
- (B) property of the estate, after the date of the filing of the petition

The only difference between subsections (A) and (B) is timing: the former covers actions taken before the petition is filed; the latter covers actions after the petition is filed.

All references to sections refer to Title 11 of the United States Code.

To block Cole's discharge under § 727(a)(2)(A), PRN had to prove by a preponderance of the evidence "(1) that the act complained of was done within one year prior to the date the petition was filed, (2) with actual intent to hinder, delay, or defraud a creditor, (3) that the act was that of the debtor, and (4) that the act consisted on transferring, removing, destroying, or concealing any of the debtor's property." *In re Jennings*, 533 F.3d 1333, 1339 (11th Cir. 2008). To block Cole's discharge under § 727(a)(2)(B), PRN had to prove the same elements by a preponderance of the evidence, except the timing on the first element changes from one year before the petition is filed to a date after the petition is filed.

PRN argues that all three of the actions described in Part B of the Background section meet these elements. The Court starts with the prepetition action.

1. The Homestead (§ 727(a)(2)(A))

[7] PRN claims that Cole concealed the value of his lakefront property by splitting it into two parcels less than two months before filing his bankruptcy petition.² The bankruptcy court rejected this claim, finding that "PRN failed to prove that Cole concealed anything" because Cole publicly recorded both deeds before filing his petition; he listed both parcels on

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his postpetition schedules; and he told the Trustee about both parcels.

- In its third amended complaint, PRN pleaded concealment of the homestead split in Count 8 (§ 727(a) (2)(A)) but not Count 9 (§ 727(a)(2)(B)). PRN's claim is thus confined to concealment that occurred "within one year before the date of the filing of the petition," 11 U.S.C. § 727(a)(2)(A) and does not include concealment that occurred "after the date of the filing of the petition." 11 U.S.C. § 727(a)(2)(B).
- 1. PRN argues that the bankruptcy court erred because it applied an unduly narrow definition of conceal. The parties rightly note that neither Congress nor this Court has defined conceal under 11 U.S.C. § 727(a). We adopt the following definition of conceal under § 727(a): "to knowingly withhold information about property or to knowingly prevent its discovery." We do so for three reasons.

First, this definition comports with the plain meaning of the word conceal, as shown by dictionary definitions at the time Congress enacted the bankruptcy code (1978) and today. See, e.g., Conceal, Oxford English Dictionary Online, https://www.oed.com/dictionary/conceal v (last visited Oct. 23, 2023) ("1.a. To keep (information, intentions, feelings, etc.) from the knowledge of others; to keep secret from (formerly also to) others; to refrain from disclosing or divulging. 1.b. To keep the nature or identity of (a person or thing) secret; to disguise. Now chiefly with as. 2.a. To hide (a person or thing); to put or keep out of sight or notice. Also: to prevent *1335 from being visible"); Conceal, Merriam-Webster Dictionary Online, https://www.merriamwebster.com/dictionary/conceal (last visited Oct. 23, 2023) ("1: to prevent disclosure or recognition of 2: to place out of sight"); Conceal, Webster's Third New International Dictionary (4th ed. 1976) ("1: to prevent disclosure or recognition of; avoid revelation of; refrain from revealing; withhold knowledge of; draw attention from; treat so as to be unnoticed; 2: to place out of sight; withdraw from being observed; shield from vision or notice").

Second, our sister circuits have similarly defined conceal under both § 727(a) and 18 U.S.C. § 152, which each address the concealment of assets from the bankruptcy estate. *See, e.g., United States v. Turner*, 725 F.2d 1154, 1157 (8th Cir. 1984) (holding in a § 152 case that concealment includes "withhold[ing] knowledge, or prevent[ing] disclosure or recognition" (quotations omitted)); *United States v. Weinstein*, 834 F.2d 1454, 1462 (9th Cir.

1987) (affirming a § 152 conviction because concealment element met if defendant "withholds knowledge of assets about which the trustee should be told" (citation omitted)); United States v. Grant, 971 F.2d 799, 807 (1st Cir. 1992) ("The crime of concealment includes withhold[ing of] knowledge or prevent[ing] disclosure or recognition." (alteration in original) (quotations and emphasis omitted)); In re Scott, 172 F.3d 959, 967 (7th Cir. 1999) ("Concealment [for the purposes of § 727(a)] ... includes preventing discovery, fraudulently transferring or withholding knowledge or information required by law to be made known." (omission in original) (citation omitted)); United States v. Atkins, 181 F.3d 91 (Table), 1999 WL 397711 (4th Cir. 1999) (finding substantial evidence supported a § 152 conviction when defendant diverted funds from escrow account and created false documents that showed he had sent the funds to the bankruptcy court); United States v. Thayer, 201 F.3d 214, 224-25 (3d Cir. 1999) (upholding jury instruction in a § 152 case that defined concealing estate property to include "withholding knowledge concerning the existence or whereabouts of property, or knowingly doing anything else by which the person acts to hinder, delay or defraud any of the creditors"), abrogated on other grounds by Skilling v. United States, 561 U.S. 358, 130 S.Ct. 2896, 177 L.Ed.2d 619 (2010); United States v. Love, 17 Fed. App'x 796, 800 n.5 (10th Cir. 2001) (finding concealment of assets from creditors when disclosure of transfers of funds "was incomplete and the purposes of the transfers were falsely identified"); United States v. Wagner, 382 F.3d 598, 609 (6th Cir. 2004) (holding that "'concealing' property encompasses actions designed to hinder, delay, or otherwise obstruct the ability of a trustee to account for and distribute the debtor's estate").

Third, we already use this definition in criminal proceedings. District courts read the same definition when instructing jurors in criminal cases where a debtor is accused of concealing estate property from creditors or Trustees:

'Conceal' has its ordinary sense of 'to hide' or 'to prevent recognition' of something. To 'fraudulently conceal' property means to knowingly withhold information about property or to knowingly prevent its discovery while intending to deceive or cheat a creditor or custodian, usually for personal financial gain or to cause financial loss to someone else.

Eleventh Circuit Pattern Jury Instructions (Criminal Cases) O2 (2022). We have similarly defined conceal when finding that the Government offered sufficient evidence of concealment to prove money laundering under 18 U.S.C. §

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1956(a). See *1336 United States v. Dennis, 237 F.3d 1295, 1302 (11th Cir. 2001) (The defendant "fraudulently concealed property belonging to the bankruptcy estate because he knowingly withheld information related to the property and acted to prevent the discovery of the property, thereby intending to deceive the bankruptcy court, the estate's creditors, or the custodian."). We see no reason to define concealment differently in the civil context. See 6 Collier on Bankruptcy ¶ 727.02 (16th ed. 2020) ("Conduct that amounts to a concealment from creditors or from an officer of the estate charged with custody of property will in general be the same as that which constitutes a concealment under section 152 of title 18, United States Code. Cases decided under section 152 will afford helpful analogies in determining what amounts to a concealment.").

2. Using this definition, the bankruptcy court did not err in finding that Cole did not conceal his property by splitting it into two parcels because PRN presented no facts that show Cole knowingly withheld information related to the property or acted to prevent the discovery of the property. To the contrary, Cole publicly recorded both deeds and continued to pay taxes on the whole property. After Cole filed his petition, Cole told the Trustee about the split and listed both parcels in his schedules.

Because Cole did not conceal property within one year of filing his petition, we agree with the bankruptcy court that PRN failed to prove its § 727(a)(2)(A) claim.

2. Coledev (§ 727(a)(2)(B))

[8] 1. As detailed in the Background section, *supra* at 1329–30, Cole used Coledev LLC as his primary operating business from 2012 until he filed his petition in 2015. Bill and Terre Cole owned 99% of Coledev as a tenancy by the entirety and put millions of dollars into Coledev. The Coles would receive large sums of money back, likely when one of Cole's real estate projects ended.

In his schedules, Cole accurately disclosed the Coles' interest in Coledev, and he listed Coledev's value as undetermined. PRN claims that Cole should have also disclosed that the advances Cole made to Coledev were repayable shareholder loans. PRN argues that Cole's failure to list the advances as shareholder loans (available to the estate) amounts to the intentional, postpetition concealment of property done to defraud Cole's creditors and Trustee under § 727(a)(2)(B). Cole retorts that he correctly treated the advances as capital

contributions, not shareholder loans, and thus had no intent to hinder, delay, or defraud his creditors or the Trustee.

2. The parties presented competing fact and expert testimony at trial. PRN introduced Cole's accounting records that labeled the advances as "shareholder loans payable." PRN introduced Coledev's 2014 and 2015 tax records that treated the advances as shareholder loans. PRN presented Terre Cole's deposition testimony that she believed the advances were shareholder loans. And PRN offered an expert who opined that the advances were shareholder loans.

On the other hand, Cole testified that the advances were capital contributions. To bolster his testimony, Cole pointed out that he never created a promissory note for repayment; no interest accrued on the advances; Coledev's 2012 and 2013 tax returns treated the advances as "additional paid-in capital"; and Coledev's 2013 and 2014 financial statements did not show any shareholder loans from Cole to Coledev. Cole also presented an expert who opined that the advances were equitable contributions, not shareholder loans.

*1337 The Trustee testified that Cole did not hide or conceal any assets from her. She testified that she knew about Coledev once Cole disclosed his tax returns. She testified that she could ask Cole about Coledev's postpetition operations, and that Cole was cooperative and supplied all of the Coledev-related information that she requested. Based on the information Cole provided, the Trustee testified that she managed to object to Cole's claimed exemption of Coledev and propose a settlement of the issue.³

The Trustee also testified that a third party told her that, in practice, the terms "shareholder loans" and "capital contributions" are used interchangeably. PRN objects that this testimony should not have been allowed because it was based on hearsay. We do not rely on this testimony to reach our conclusions, so we needn't consider the evidentiary objection.

After reciting this evidence, the bankruptcy court found that PRN failed to prove that "Cole concealed any property after this bankruptcy case was filed intending to hinder, delay, or defraud his creditors under § 727(a)(2)(B)."

3. We read the bankruptcy court's ruling to find that PRN failed to meet its burden of proof on both the intent and concealment elements. We affirm both findings.

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As for concealment, the bankruptcy court did not clearly err in finding that Cole had not "knowingly withheld information related to the property or acted to prevent the discovery of the property" when he did not label his advances to Coledev as shareholder loans. The bankruptcy court could reasonably rely on the Trustee's testimony that Cole did not hide or conceal any information from her and that she discovered the 'loan versus equity' issue once Cole disclosed his tax returns to find that Cole was not concealing information. This finding is bolstered by the Trustee's testimony that Cole provided her with any information or documents she asked for.

As for intent, the bankruptcy court did not clearly err in finding that Cole did not intend to "hinder, delay, or defraud" PRN or the Trustee when he did not label his advances to Coledev as shareholder loans. 11 U.S.C. § 727(a)(2). The bankruptcy court heard Cole's testimony and found that Cole lacked a fraudulent intent. The bankruptcy court also heard and found credible the Trustee's testimony that Cole had concealed no information from her and had cooperated with her when she had questions about Coledev. When this Court "examine[s] the facts adduced at trial, generally we will not disturb a bankruptcy court's credibility determinations." In re Kane, 755 F.3d 1285, 1288 (11th Cir. 2014). We find no reason to second guess the bankruptcy court's credibility findings, especially when other evidence (e.g., the lack of a promissory note or accrued interest) supports Cole's belief that he was making equitable contributions rather than loans to Coledev.

Because we find no error in the bankruptcy court's findings about concealment and Cole's intent, we affirm its denial of relief under 11 U.S.C § 727(a)(2)(B).

3. COLP (§ 727(a)(2)(B))

[9] 1. As explained in the Background section, *supra* at 1329–30, Cole created COLP to hold the Coles' personal investments. Cole transferred about \$4 million from COLP into the Coles' tenancy by the entireties in December 2011 and January 2012. Cole says that he decided to close COLP in 2010 and that the \$4 million transfers that began in late 2011 were part of the winding down of COLP.

While Cole disclosed 14 businesses in his schedules, he did not disclose COLP or its 1% general partner, W&T Cole, LLC. *1338 PRN alleged that Cole violated § 727(a)(2)(B) by concealing COLP to hide the \$4 million transfers from his creditors and the Trustee.

In a separate proceeding, the Trustee filed a claim against Cole to recover Cole's personal interest in the \$4 million COLP transfers, arguing that Cole made the \$4 million transfer to hinder PRN's collection efforts. *See* 11 U.S.C § 544(b)(1) (allowing the Trustee to avoid transfers made by the debtor that are voidable under applicable state law).

2. Cole testified about COLP twice at trial. Cole told Judge Jackson that his failure to disclose COLP was an "inadvertent mistake." After assuming the case, Judge Jennemann recalled Cole and the Trustee to ask more questions about COLP. Cole told Judge Jennemann that he missed COLP because he had several entities that contained the name "Cole"; COLP was not listed in his record of Florida businesses because COLP was a Nevada partnership; and COLP had no valuable assets when he filed his petition. Cole also pointed out that he listed COLP as a co-obligor in another schedule; he disclosed the existence of an account held by COLP at his creditors meeting; and he gave the Trustee COLP's financial records when they discovered that Cole omitted COLP from his list of businesses.

The Trustee testified that Cole should have listed COLP on his schedules and that she (the Trustee) could not focus on COLP initially because of the omission. But the Trustee confirmed that Cole gave her testimony and documents about the \$4 million COLP transfers the next time she saw Cole after COLP was discovered during the creditors' meeting.

3. The bankruptcy court (Judge Jennemann) ruled on the Trustee's claim and PRN's claim in separate orders. In the Trustee proceeding, the court found that the Trustee proved that Cole transferred the \$4 million from COLP to his tenancy by the entireties in late 2011 to hinder PRN's ability to collect on Cole's debts to PRN. As a result, the court granted partial summary judgment for the Trustee and ordered a trial to determine Cole's interest in the \$4 million so that amount could be recovered for the estate. *See* 11 U.S.C. § 550(a) (allowing the Trustee to recover avoided transfers from the recipient). The parties settled that claim before trial.

In this case, the bankruptcy court found that PRN failed to prove that Cole omitted COLP from his list of businesses in 2015 with the intent to hinder, delay, or defraud PRN or the Trustee. The court found Cole to be "forthright and candid" during his supplemental testimony and found that his testimony was "credible and believable." The court found that Cole's initial listing of COLP in a different part of his schedules and Cole's prompt disclosure of COLP's records

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once the omission was discovered disproved PRN's theory that Cole was trying to hide COLP. So the court rejected PRN's postpetition concealment claim under § 727(a)(2)(B).

4. We affirm. The bankruptcy court based its ruling largely on a credibility determination. As stated, we generally defer to the bankruptcy court's credibility determinations. *See Kane*, 755 F.3d at 1288. Knowing this, PRN argues that we should not apply standard deference here because (a) Judge Jennemann told Cole that she wanted more testimony about the COLP omission, so Cole had time to prepare his supplemental answers, and (b) Cole testified by live video (Zoom), rather than in person, so the court was less capable of judging his demeanor.

Cole argues that PRN waived these arguments because PRN did not object to Judge Jennemann taking supplemental *1339 testimony, or taking the supplemental testimony by Zoom, during the bankruptcy court proceedings. PRN did not address waiver in its reply brief. Because PRN does not point to its objections to the bankruptcy court, and we have not found any, we find that PRN waived both arguments. See Telfair v. First Union Mortg. Corp., 216 F.3d 1333, 1337 n.6 (11th Cir. 2000) (arguments raised to this Court and the district court, but not the bankruptcy court, will not be heard on appeal).

We also find both arguments meritless. Judge Jennemann did not err by telling the parties the topic for reexamination. Nor was her order prejudicial. Cole has known that PRN or the bankruptcy court could question him about his failure to list COLP in his schedules since PRN pleaded the allegation in its complaint. Telling Cole that the court wanted *more* testimony on a known topic did not prejudice PRN.

[10] Nor does taking testimony by Zoom diminish the bankruptcy court's credibility findings. We generally defer to the trier of fact's credibility determination because the fact finder heard the witness's testimony and saw his demeanor, while we are stuck with a "cold paper record." *United States v. Peters*, 403 F.3d 1263, 1270 (11th Cir. 2005). While we agree that in-person testimony is preferable to a live video stream, the bankruptcy court could hear Cole testify and watch his demeanor live. Because PRN did not object to the Zoom feed at the time, we must assume that the court was able to judge Cole's credibility the same as if Cole was sitting in the witness box. And whatever the quality of the feed, the live video stream gave the bankruptcy court greater insight into Cole's credibility than the cold paper record gives us. *See id.*

We thus give due regard to the bankruptcy court's determination that Cole's testimony was "credible and believable." Having reviewed the record, we cannot hold that this finding is clearly erroneous. As the bankruptcy court noted, Cole's testimony is backed by Cole's listing of COLP in a different part of the schedules, followed by his disclosure of COLP and COLP records in later meetings with the Trustee and creditors. While the bankruptcy court's finding that Cole fraudulently transferred COLP's assets in 2011-2012 to shield it from PRN gives us reason to question whether Cole knowingly concealed COLP's existence in 2015 to cover up his earlier fraud, it is apparent from the record that the bankruptcy court had the same concern. Unlike this Court, the bankruptcy court could recall Cole to ask him about his 2015 actions, and the court believed his answers. Because certain evidence supports that finding, we affirm it.

B. False Oath (§ 727(a)(4))

[11] [12] Section 727(a)(4) precludes the bankruptcy court from granting a discharge if the court finds, in relevant part, that "the debtor knowingly and fraudulently, in or in connection with the case, made a false oath or account. ..." A debtor can make a false oath in his petition, in his schedules, at creditor meetings, and when giving sworn testimony. See, e.g., In re Chalik, 748 F.2d 616, 617-19 (11th Cir. 1984) (affirming the bankruptcy court's finding that the debtor omitted relevant businesses from his schedules); In re Whigham, 770 Fed. App'x 540, 545-46 (11th Cir. 2019) (affirming the bankruptcy court's finding that the debtor made a false oath in court filings and during questioning); Collier on Bankruptcy, supra, ¶ 727.04 ("The false oath that is a sufficient ground for denying a discharge may consist of (1) a false statement or omission in the debtor's schedules or (2) a false statement by the debtor at an examination during the course of the proceedings."). The *1340 false oath must be fraudulent and material. Chalik, 748 F.2d at 618.

PRN argues that Cole made false oaths in connection with the same three actions discussed in the previous section. We discuss the claims in the same order as before.

1. The Homestead

PRN argues that Cole made two false oaths related to his homestead property: (1) Cole wrongly described his property as two parcels in his schedules, and (2) Cole lied when he

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testified that he divided the property because he believed the State of Florida owned the submerged land. The bankruptcy court found that PRN failed to plead this false oath claim in its operative complaint and that, even if it had, PRN failed to prove its claim. This Court reviews the pleading ruling *de novo*, and we review the merits ruling for clear error. We affirm both.

[13] 1. We start with pleading. Because fraud is a necessary element in a false oath claim, PRN had to meet the heightened pleading standard of Rule 9(b) of the Federal Rules of Civil Procedure. See Fed. R. Bankr. P. 7009 ("Rule 9 F.R.Civ.P. applies in adversary proceedings."). PRN pleaded its false oath claim in Count 11. After incorporating 66 paragraphs of general allegations, some of which described the homestead division, PRN pleaded the rest of Count 11 like this:

The Debtor knowingly and fraudulently, in or in connection with this case has made multiple false oaths and accounts, including: i) failing to include all assets in his Schedules and SOFA while testifying under oath they were accurate; ii) failing to provide accurate information with respect to his income; iii) claiming that he is utilizing assets he claims are owed as tenancies-by-the-entirety in order to fund his lifestyle; and iv) claiming that Coledev is owned as tenancy by the entireties while recently stating under oath he was the sole owner of the same.

Based upon the foregoing, Plaintiff seeks a declaration and determination that the Debtor is not eligible for a discharge under Section 727(a)(4)(A) of the Bankruptcy Code.

While some paragraphs PRN incorporated from another part of the complaint described the homestead division, PRN did not mention Cole's homestead division in Count 11. PRN instead listed four other actions or failures to act. PRN thus failed to put Cole on notice that PRN intended to pursue a homestead-based false oath claim at trial.

PRN perpetuated the limited scope of its false oath claim when it failed to mention Cole's homestead division as part of the claim in its pretrial brief and its posttrial brief. PRN did not associate the homestead division with its false oath claim until it responded to the bankruptcy court's invitation to comment on its preliminary posttrial opinion.

[14] [15] We agree with the bankruptcy court that PRN failed to plead with the requisite particularity a false oath claim based on Cole's homestead division before trial. And we find no error in the bankruptcy court's refusal to amend PRN's complaint after trial to add a homestead-based false oath

claim under Rule 15(b). Rule 15(b) requires Cole's express or implied consent to the amendment. Cole has not expressly consented to the amendment; he objects to it. And courts will not find implied consent "if the defendant had no notice of the new issue, if the defendant could have offered additional evidence in defense, or if the defendant in some other way was denied a fair opportunity to defend." *1341 Cioffe v. Morris, 676 F.2d 539, 541-42 (11th Cir. 1982). The bankruptcy court found that it would be unfair and prejudicial to allow PRN to "fix" its pleading deficiency after the court took evidence and issued its preliminary opinion. This finding of prejudice is supported by the record and thus precludes amendment by implied consent under Rule 15(b).

[16] 2. Even if PRN pleaded a false oath claim related to Cole's homestead division, the bankruptcy court did not clearly err when it alternatively rejected the claim on the merits. The bankruptcy court found that Cole did not make a false oath when he listed his property as two parcels in his schedule because, at the time, Cole's property *was* legally divided into two parcels. Plus, Cole's attorney told the Trustee about the division before Cole filed his schedule, thus belying any argument that Cole fraudulently listed his property as two parcels. Having reviewed the record, we find no clear error with these findings.

[17] As for Cole's testimony that he believed Florida owned the submerged land, Judge Jennemann noted that Judge Jackson had not ruled whether Cole or PRN was correct about ownership of submerged lands; she instead stated that both parties presented "reasoned arguments" and the issue was "both fascinating and complex." Based on Judge Jackson's statement that Cole's position was "reasoned," Judge Jennemann found it impossible to rule that Cole fraudulently testified under oath during the homestead exemption trial (which Judge Jackson observed) or during this trial (which Judge Jennemann observed). As stated, we generally defer to the credibility determinations of the bankruptcy courts. Because the court did not find that Cole testified falsely under oath, we find no clear error in the bankruptcy court's rejection of PRN's testimony-based false oath claim.

To sum up, we find that PRN did not plead a false oath claim related to Cole's homestead division and was not entitled to a posttrial amendment to add that claim. Further, the bankruptcy court did not clearly err in its alternative ruling

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that PRN failed to prove a false oath claim related to Cole's homestead division. So we affirm the bankruptcy court's ruling on both grounds.

2. Coledev

[18] Again, PRN argues that Cole should have listed his \$1 million in advances to Coledev as "shareholder loans payable." PRN thus alleges that, when Cole signed his schedules as true and correct, despite not listing the Coledev advances as shareholder loans payable, he knowingly and fraudulently made a false oath in violation of § 727(a)(4).

The bankruptcy court found that Cole reasonably believed that the advances were equitable contributions, not shareholder loans. The court thus found that PRN failed to prove that Cole had an intention of hindering, delaying, or defrauding his creditors or the Trustee.

False oath claims under § 727(a)(4) are similar, but a bit broader, than concealment claims under § 727(a)(2) because the intent to defraud needn't be targeted at anyone, including the creditors and Trustee. *See* Collier on Bankruptcy, *supra*, ¶ 727.04. But that distinction does not matter here because the bankruptcy court found that Cole honestly believed that the advances were capital contributions, meaning that he had no fraudulent intent when he did not list the advances as shareholder loans.

Further, "[a] debtor coming forward of his or her own accord to correct an omission is strong evidence that there was no fraudulent intent in the omission." *Id.* The *1342 Trustee testified that, once the Coledev issue was identified, Cole was cooperative and supplied all of the Coledev-related information that she requested. The bankruptcy court found the Trustee's testimony credible.

We find no reason to second guess the bankruptcy court's credibility findings, especially when other evidence (e.g., the lack of a promissory note or accrued interest) supports Cole's belief that he made equitable contributions to Coledev. We thus affirm the rejection of PRN's false oath claim for failure to prove a knowing and fraudulent intent.

3. COLP

[19] Finally, PRN claims that Cole violated § 727(a)(4) when he signed his Statement of Financial Activities as true and accurate despite failing to list COLP and its 1% partner, W&T Cole, LLC on his list of businesses. The bankruptcy court

rejected this claim because it found Cole's omission of COLP to be "inadvertent—not intentional."

As detailed *supra* at 1338, Judge Jennemann had reservations about Cole's initial testimony on COLP, so she recalled him to testify on the topic. Judge Jennemann found Cole to be "forthright and candid," and she found his testimony "credible and believable." The bankruptcy court therefore found that PRN failed to prove that Cole intentionally and fraudulently left off COLP from his list of businesses.

For the same reasons discussed in the concealment section, *supra* at 1338–40, we affirm. The bankruptcy court is in a better position than this Court to judge Cole's credibility, and we find no clear error in its determination that Cole did not knowingly and fraudulently omit COLP in violation of § 727(a)(4).

In sum, we affirm all of the bankruptcy court's rulings under 11 U.S.C. § 727(a), meaning that Cole was entitled to a discharge of all debts, minus any individual debt excepted under 11 U.S.C. § 523. See 11 U.S.C. § 727(b). We now turn to PRN's claim to except a debt under § 523(a)(2)(A), the so-called "Husky" claim.

C. *Husky* Claim (§ 523(a)(2)(A))

Fraudulent transfers generally involve two parties: the transferor and the recipient. Bankruptcy debtors are usually the transferor trying to conceal assets from creditors and the estate. Four code provisions cover this scenario. If the debtor transferred assets less than a year before filing his bankruptcy petition, or after he filed his petition, then § 727(a)(2) allows the Trustee or a creditor to seek total preclusion of a discharge. If the transfer occurred less than two years before the debtor filed his petition, then § 548(a)(1) allows the Trustee to nullify the transfer, and § 550(a) allows the Trustee to retrieve the money for the estate. If the transfer occurred more than two years before the debtor filed his petition, then § 544(b)(1) allows the Trustee to seek the same remedies (avoidance and retrieval) if the transfer is voidable under state law.

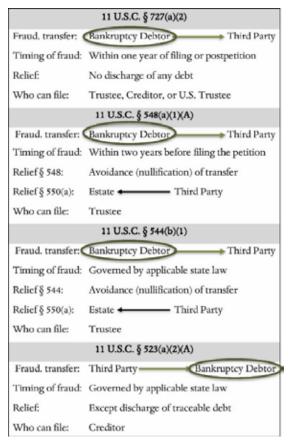
While these provisions cover the usual scenario of debtors transferring assets, sometimes the debtor *receives* a fraudulent transfer. That's where § 523(a)(2) kicks in. If someone sends the bankruptcy debtor money to fraudulently avoid his debt,

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the party owed the money can have the debt excepted from the recipient debtor's discharge—if the creditor can show that, under state law, the recipient took on the sender's debt.

The proceedings below and before this Court reveal much confusion about the interplay among these provisions. So we *1343 create this chart to highlight the key distinctions:



In separate proceedings, PRN and the Trustee invoked one of these provisions to challenge the \$4 million COLP transfers. The Trustee sought to nullify the transfers under § 544(b) (1) and retrieve Cole's personal interest in the money under *1344 § 550(a)(1). The Trustee and Cole settled this claim for \$350,000.

In Count 3, PRN sought to except a debt that, PRN claims, Cole assumed from COLP under § 523(a)(2)(A).⁴ PRN alleged that when Cole caused COLP to transfer \$4 million to the Coles' TBE account, Cole obtained both COLP's money and COLP's contribution debt to PRN arising from PRN's payment of the SunTrust loans. PRN did not ask to retrieve or set aside Cole's personal interest in the \$4 million transfer.⁵

Rather, PRN asked for a discharge exception so that it can collect COLP's contribution debt from Cole.

- PRN pleaded various challenges to the COLP transfers in Counts 3-6 of its complaint. The district court held that PRN waived Counts 4-6 on appeal because of inadequate briefing. PRN does not challenge that ruling in its briefs, and PRN expressly dropped Counts 5-6 in its opening brief. PRN primarily focused on Count 3 in its later briefing and at argument. So we limit our review to Count 3. Counts 4-6 remain dismissed.
- Unlike Count 3, PRN requested that Cole's 49.5% personal interest in COLP's assets be deemed non-dischargeable in Count 4. This may explain why the bankruptcy and district courts held that the Trustee's action preempted Cole's action and why Cole shies away from that count on appeal.

The bankruptcy court summarily dismissed Count 3, finding "that PRN is asking for a cause of action that just isn't there, and to the extent that it ever could be there, it would belong to the Trustee." We understand the bankruptcy court's ruling to mean that (a) PRN failed to plead a viable claim under § 523(a)(2)(A) but, if it did, (b) the Trustee's action to avoid the transfer under § 544(b) and to retrieve Cole's personal interest in COLP's assets under § 550(a) preempted PRN's § 523(a) (2)(A) discharge exception claim. As a result, the bankruptcy court did not consider the merits of PRN's claim.

As explained below, we find that the bankruptcy court erred on both counts: viability and preemption. To explain why, though, we must first dive deeper into § 523(a)(2)(A) and the case that lends its name to claims filed under that provision: *Husky Int'l Elecs., Inc. v. Ritz*, 578 U.S. 355, 136 S.Ct. 1581, 194 L.Ed.2d 655 (2016).

1. Defining a *Husky* claim

[20] Pared down to its relevant part, § 523(a)(2)(A) says that an otherwise complete discharge under § 727 "does not discharge an individual debtor from any debt ... for money ... to the extent obtained by ... actual fraud." The Supreme Court has clarified that the phrase "to the extent obtained by" modifies "money," not "any debt." *Cohen v. de la Cruz*, 523 U.S. 213, 218, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998). Section 523(a)(2)(A) thus "turns on how the money was obtained." *Bartenwerfer v. Buckley*, 598 U.S. 69, 72, 143 S.Ct. 665, 214 L.Ed.2d 434 (2023). If the debtor obtained money by actual fraud, then "any debts 'traceable to' the fraudulent

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conveyance will be nondischargeable under § 523(a)(2)(A)." *Husky*, 578 U.S. at 365, 136 S.Ct. 1581 (citations omitted).

To define a viable claim under this provision, we look to the Supreme Court's decision in *Husky* and our most detailed treatment of *Husky*: *In re Gaddy*, 977 F.3d 1051 (11th Cir. 2020).

1. *Husky* shares an important fact with this case: The bankruptcy debtor, Daniel Ritz, used companies he controlled to both send and receive money by actual fraud. Ritz was the director and 30% owner of Chrysalis Manufacturing Corp. *Husky*, 578 U.S. at 357, 136 S.Ct. 1581. Chrysalis bought electronic parts from Husky International Electronics. *Id.* Chrysalis owed *1345 Husky about \$164,000 when Ritz used his power as Chrysalis' director to transfer at least \$270,000 to other businesses Ritz controlled, making Chrysalis unable to pay its \$164,000 debt to Husky when Chrysalis filed for bankruptcy. *Id.* at 357-58, 136 S.Ct. 1581.

Husky sued Ritz under a Texas veil piercing statute that makes shareholders liable for corporate debts if the shareholder committed actual fraud. *See* Tex. Bus. Orgs. Code Ann. § 21.223(b). Ritz later filed for Chapter 7 bankruptcy, and Husky filed a claim for exception under 11 U.S.C. § 523(a) (2)(A), arguing that under Texas's veil piercing statute, Ritz obtained Chrysalis' debt to Husky when he caused Chrysalis to transfer money to other Ritz-owned companies. *Husky*, 578 U.S. at 358, 136 S.Ct. 1581.

The district court agreed with Husky that Ritz was liable for Chrysalis' debt under Texas law but held that § 523(a) (2)(A) did not apply because Ritz did not obtain Chrysalis' debt by actual fraud. *Id.* at 358, 136 S.Ct. 1581. The Fifth Circuit affirmed, finding that Ritz did not commit actual fraud because the transfer of money from one Ritz company to other Ritz companies did not involve a fraudulent misrepresentation. *Id.* at 358-59, 136 S.Ct. 1581.

The Supreme Court reversed, finding that "actual fraud ... can be effected without a false representation." *Id.* at 359, 136 S.Ct. 1581 (quotations omitted). Actual fraud "is not in dishonestly inducting a creditor to extend a debt. It is in the acts of concealment and hinderance." *Id.* at 362, 136 S.Ct. 1581.

After rejecting the Fifth Circuit's rationale, the Court then tackled two other arguments relevant here. First, the Court rejected Ritz's argument that Husky's reading of § 523(a)

(2)(A) made the provision redundant with § 727(a)(2). The Court noted that, while both provisions "could cover some of the same conduct, they are meaningfully different" in scope and timing. *Id.* at 364, 136 S.Ct. 1581. As for scope, the Court noted that relief under § 727(a)(2) is the broader, "blunt remedy" of blocking the discharge of any debt. *Id.* As for timing, the Court noted that a § 727(a)(2) claim arises only in the year before the petition is filed, a limitation that does not apply to § 523(a)(2)(A). *Id.* Because the two provisions differ in timing and scope of relief, creditors can use either (if available).

Second, the Court rejected Ritz's argument that debts are not "obtained by" a fraudulent transfer of monies because the person who sent the money—the transferor—was already in debt to the creditor when the transfer occurred:

It is of course true that the transferor does not 'obtain' debts in a fraudulent conveyance. But the recipient of the transfer—who, with the requisite intent, also commits fraud—can 'obtain' assets 'by' his or her participation in the fraud. If that recipient later files for bankruptcy, any debts 'traceable to' the fraudulent conveyance will be nondischargeable under § 523(a)(2)(A). 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 receives fraudulently conveyed assets is not necessarily (or even likely to be) a debtor on the verge of bankruptcy, but they make clear that fraudulent conveyances are not wholly incompatible with the 'obtained by' requirement.

*1346 *Id.* at 365, 136 S.Ct. 1581 (citations and footnote omitted) (cleaned up). In short, the Court agreed that § 523(a) (2)(A) cannot apply to the party who fraudulently transferred money because his debt preexisted the fraud. But while it "may be rare," *id.*, § 523(a)(2)(A) can apply to the party who received the money because his debt resulted from the fraudulent transfer.

The Supreme Court remanded the case to the Fifth Circuit, who in turned remanded to the bankruptcy court to determine whether Ritz assumed Chrysalis' debt to Husky under Texas's veil piercing law. *See In re Ritz*, 832 F.3d 560, 565-66 (5th Cir. 2016). The bankruptcy court tried the case and found that, through actual fraud, Ritz "became personally liable to Husky by virtue of the Texas veil-piercing statute." *In re Ritz*, 567 B.R. 715, 773 (Bankr. S.D. Tex. 2017). Because Ritz's debt could be traced to his fraudulent receipt of money, the bankruptcy court held that § 523(a)(2)(A) precluded Ritz from discharging the debt. *Id*.

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2. Our *Gaddy* decision starts with facts similar to this case. The bankruptcy debtor, Jerry Gaddy, took part in a real estate development project. In 2006, Gaddy's business, Water's Edge LLC, received two loans from Vision Bank, who we will call SEPH going forward based on a later merger. *Gaddy*, 977 F.3d at 1054. Gaddy personally guaranteed the SEPH loans for just over \$10 million when they were made, then increased his guarantee to \$12.5 million in 2008. *Id.*

The project had more than 30 guarantors, including Gaddy. The project became troubled in 2009, and SEPH warned the guarantors of potential default. Less than two weeks later, Gaddy started transferring property to an LLC he created for his wife and daughter. *Id.* Gaddy continued these transfers through 2014.

Water's Edge defaulted on the SEPH loans in 2010. So SEPH demanded Gaddy pay the loans as the guarantor, and SEPH sued Water's Edge, Gaddy, and other guarantors to reclaim its losses on the project. SEPH won the lawsuit, including a \$9.1 million judgment against Gaddy. *Id.* All the while, Gaddy kept transferring assets to his wife and daughter.

So SEPH sued Gaddy and his wife (and later their daughter) under Alabama's fraudulent transfer law. *Id.* Gaddy, in turn, filed for Chapter 7 bankruptcy. *Id.* Relying on *Husky*, SEPH argued that the transfers from Gaddy to his family amounted to actual fraud, thus requiring the bankruptcy court to except SEPH's \$9.1 million judgment against Gaddy under § 523(a) (2)(A). The bankruptcy court rejected the exception, finding that SEPH could not allege or prove that Gaddy's debt to SEPH "was obtained by fraud or was anything other than a standard contract debt." *Id.* at 1055.

We affirmed. We noted that, "for a debt to be exempt from discharge under § 523(a)(2)(A), the money or property giving rise to the debt must have been 'obtained by' fraud, actual or otherwise." *Id.* at 1057. But the "Water's Edge debt existed long before Gaddy began transferring his assets, and that debt is an ordinary contract debt that did not arise from fraud of any kind." *Id.* at 1058. In other words, Gaddy's debt was not traceable to the fraudulent transfer of money to his family; Gaddy's debt resulted from the non-fraudulent guarantee of the SEPH loans. So § 523(a)(2)(A) could not apply.

[21] [22] [23] Taken together, *Husky* and *Gaddy* teach that, for a creditor to except a debt under § 523(a)(2) (A), the creditor must show that (a) the bankruptcy debtor *1347 obtained money, property, or services by actual fraud; and, (b) the debt to be excepted resulted from the debtor's fraudulent receipt. Further, § 523(a)(2)(A) can only apply to the recipient of a fraudulent transfer because the transferor did not "obtain" money, property, or services, and his debt necessarily resulted from an earlier event.

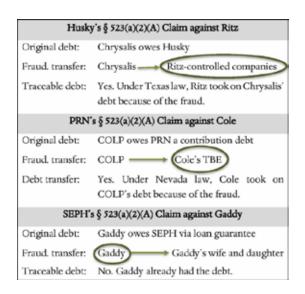
As long as fraud was involved when the debtor obtained the assets, the debtor need not be the party who committed the fraud for § 523(a)(2)(A) to apply. See Bartenwerfer, 598 U.S. at 83, 143 S.Ct. 665.

With these requirements in mind, we now turn to the bankruptcy court's ruling that PRN failed to plead a viable *Husky* claim, or if it did, the Trustee's action preempted PRN's claim

2. Viability

[24] We find that PRN pleaded a viable claim of exception under § 523(a)(2)(A). PRN alleges that Cole obtained money by actual fraud—*i.e.*, the transfer of money from a non-exempt limited partnership to an exempt TBE account to hinder PRN's claim for the money. And PRN alleges that, under state law, Cole took on COLP's debt when he fraudulently obtained COLP's money.

Placing PRN's allegations in our chart shows that PRN's claim mirrors the claim in *Husky*, not *Gaddy*:



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Because PRN's claim fits within the plain language of § 523(a)(2)(A) and mirrors the *Husky* claim in all relevant parts, we find that the bankruptcy court erred when it *1348 found that PRN did not plead a viable cause of action in Count 3. We also disagree with the district court's additional findings that (a) PRN pleaded transferor liability, rather than recipient liability, and (b) under state law, Cole could not obtain COLP's debt when he obtained COLP's money by actual fraud. To explain why, we must first choose between PRN's alternate pleading of Nevada and Florida law.

1. Nevada's alter ego law applies. Circuit courts have split when choosing between federal and state choice of law rules in bankruptcy. See In re First River Energy, LLC, 986 F.3d 914, 924 n.19 (5th Cir. 2021) (noting the split). In an unpublished opinion, we have stated that federal courts apply the forum state's choice of law rules in bankruptcy cases. Mukamal v. Bakes, 378 Fed. App'x 890, 896 (11th Cir. 2010). But we needn't decide whether to officially adopt that rule here because both federal and Florida law tell us to apply the Restatement (Second) of Conflict of Laws and thus would lead to the same result. See Bishop v. Fla. Specialty Paint Co., 389 So. 2d 999, 1001 (Fla. 1980) (looking to the Restatement (Second) for choice of law issues); First River Energy, 986 F.3d at 924 (not deciding between Texas or federal choice of law rules because both bodies of law reached the same result by pointing to the Restatement (Second)).

The Restatement says that courts must follow "a statutory directive of its own state on choice of law." Restatement (Second) of Conflict of Laws, § 6(1) (Am. Law Inst. 1977). If the state has not adopted a statute that directs the choice of law, the Restatement requires courts to consider seven factors listed in § 6(2).

Florida has a statute on point, so the statute controls. *Id.* § 6(1). COLP is a limited partnership organized in Nevada. Section 620.1901(1) of the Florida Statutes provides that "[t]he laws of the state or other jurisdiction under which a foreign limited partnership is organized govern relations among the partners of the foreign limited partnership and between the partners and the foreign limited partnership and the liability of partners as partners for an obligation of the foreign limited partnership." (emphasis added). Because COLP is foreign to Florida, Nevada law governs the liability of COLP's partners for COLP's obligations.

2. Nevada law says that an individual cannot be personally liable for a corporation's debt unless the individual "acts as

the alter ego of the corporation." Nev. Rev. Stat. § 78.747. A person acts as a corporation's alter ego "only if: (a) The corporation is influenced and governed by the person; (b) [t]here is such unity of interest and ownership that the corporation and the person are inseparable from each other; and (c) [a]dherence to the notion of the corporation being an entity separate from the person would sanction fraud or promote a manifest injustice." *Id*.

The Supreme Court of Nevada answered three relevant certified questions about this statute in *Magliarditi* v. *TransFirst Group, Inc.*, 135 Nev. 681, No. 73889, 2019 WL 5390470, at *1 (filed Oct. 21, 2019) (unpublished disposition). First, the court said that creditors can file a cause of action against the alter ego to make him personally liable for the corporation's debt. *Id.* at *2-3. Second, the court said that § 78.747 applies to partnerships, in addition to corporations. *Id.* at *3. And third, the court said that the alter ego becomes a *1349 "debtor" (*i.e.*, "a person who is liable on a claim" of the creditor) when the alter ego violates Nevada's version of the Uniform Fraudulent Transfer Act. *Id.* at *4-5 (looking at Nev. Rev. Stat. § 112.140, *et seq.* (2017)).

Magliarditi is unpublished. Rule 36(c) of the Nevada Rules of Appellate Procedure states that an unpublished opinion may be cited for its persuasive value and citations must be to an electronic database. We cite Westlaw

Applying the high court's reading of Nevada law here, PRN can plead a state law alter ego claim against Cole for fraudulently transferring COLP's assets to the Coles' TBE, and if PRN proves that claim, Cole becomes liable for COLP's contribution debt to PRN. Because Cole's debt to PRN arises from his role in a fraudulent transfer—or, as § 523(a)(2)(A) puts it, Cole would possess a "debt for money ... obtained by ... actual fraud"—PRN has pleaded a viable *Husky* claim.

3. Cole argues that even if PRN could plead a viable *Husky* claim, the district court rightly affirmed the dismissal of Count 3 because PRN pleaded transferor liability like *Gaddy*, rather than recipient liability like *Husky*.

[25] As explained, we agree with Cole that the party who fraudulently transfers money to avoid paying an existing debt is not subject to § 523(a)(2)(A)'s exception because that party did not "obtain" money by fraud and his (preexisting) debt is not traceable to the fraudulent transfer. *See Gaddy*, 977 F.3d at 1057-58. But COLP would be the forbidden transferor here,

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not Cole, because COLP, not Cole, possessed the debt at issue before the transfer.

Count 3 properly alleges that, by application of Nevada law, Cole became liable for COLP's debt when Cole fraudulently obtained COLP's assets:

- 94. Pursuant to Nevada common law and Nevada Revised Stated [sic] Section 78.746, the Debtor is liable to PRN for the subsequent fraudulent transfers and conversions made by Cole [of] Orlando. ...
- 103. By causing Cole of Orlando to make the [\$4 million transfers], the Debtor obtained debts owed to PRN which are the subject of this Count against the Debtor.
- 104. By causing the [\$4 million transfers], the Debtor obtained assets that are directly traceable to the transfers from Cole of Orlando because he obtained the right to the whole of the assets transferred and he conspired with [Terre] Cole to hinder, delay[,] or defraud PRN by transferring the assets.

As discussed, under Nevada law, PRN must prove that Cole (as COLP's alter ego) forced COLP to transfer its assets to establish that Cole became responsible for COLP's debt to PRN when he obtained COLP's assets. So when PRN pleaded that Cole caused the COLP transfers, PRN did so out of necessity—not out of error.

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In sum, PRN pleaded facts in Count 3 that, if proved, would show that (a) Cole obtained COLP's money by actual fraud, and as a result, (b) Cole became responsible for COLP's debt to PRN. As a result, the bankruptcy court erred in holding that PRN did not state a viable cause of action to except that debt from discharge under 11 U.S.C. § 523(a)(2)(A).

3. Preemption

Alternatively, the bankruptcy court held that, even if PRN had a viable cause of action stemming from the COLP transfers, "it would belong to the Trustee," who sought to avoid the transfers under § 544(b) and retrieve Cole's portion of the money under § 550(a). Cole casts this ruling as one of standing and argues that the Trustee had exclusive standing to challenge *1350 the COLP transfers under § 544(b). We disagree.

1. For starters, Cole raises a question of preemption, not standing. Assuming the pleaded facts are true, PRN meets the requirements for Article III standing: (1) the fraudulent transfers injured PRN by rendering COLP unable to pay its debt to PRN; (2) Cole caused PRN's injury by causing COLP to transfer its money to an exempt TBE account; and, (3) excepting from discharge any debt traceable to Cole's fraudulent receipt of COLP's money would redress PRN's injury because PRN could seek payment from Cole. See Lujan v. Defs. of Wildlife, 504 U.S. 555, 560-61, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992) (listing the elements of standing). And Congress gave creditors like PRN the ability to seek exceptions to redress their injuries. See 11 U.S.C. § 523(c)(1) (permitting creditors to request an exception under § 523(a) (2) and requiring notice and a hearing before the bankruptcy court can determine whether to except the challenged debt from discharge).

As a result, the question is not whether PRN had standing to plead its § 523(a)(2)(A) claim or whether the bankruptcy court had subject matter jurisdiction to hear PRN's claim. They did. Rather, the question is whether the Trustee's action to avoid the \$4 million transfers under § 544(b)(1) and recover Cole's personal interest in the money under § 550(a)(1) preempted PRN's statutory right to seek a discharge exception for a debt owed to it.

[26] 2. The Trustee's § 544(b) action did not preempt PRN's § 523(a) action. No Code provision extinguishes a creditor's right to seek a discharge exception under § 523(a)(2)(A) because the Trustee seeks to avoid a fraudulent transfer under § 544(b) or § 548(a) or the full denial of discharge under § 727(a). Nor does it appear that Congress intended Trustees to have exclusive authority to press claims based on fraudulent transfers. For example, if a fraudulent transfer happens within one year of the petition, Congress gives the Trustee and creditors the right to challenge the discharge under § 727(a) (2). See 11 U.S.C. § 727(c)(1). This case proves that both can challenge a fraudulent transfer under § 727(a)(2): PRN challenges the Coledev transfers under § 727(a)(2) in this appeal, without a standing or preemption challenge, see Parts III(A)(2), (B)(2), despite the Trustee settling the same § 727(a)(2) claim in her own action.

[27] Further, Congress added "actual fraud" to § 523(a)(2) (A) as part of the Bankruptcy Reform Act of 1978. *See Husky*, 578 U.S. at 359, 136 S.Ct. 1581. As the Supreme Court noted about this addition in *Husky*, when "Congress acts to amend a statute, we presume it intends its amendment to have real and

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substantial effect." *Id.* (quotation omitted). If Cole is correct that Trustees have exclusive authority to challenge fraudulent transfers under §§ 544 and 548, then Congress' addition of "actual fraud" to creditors' § 523 arsenal was meaningless. Courts must allow creditors to raise "actual fraud" claims under § 523(a)(2)(A), even if Trustees can raise avoidance claims under § 544(b) or § 548(a), to give that provision real and substantial effect.

Finally, Trustees and creditors have different interests, and thus seek different outcomes, when they invoke Chapter 5 to challenge a fraudulent transfer. When a Trustee invokes § 544 or § 548, plus § 550, he seeks to nullify the transfer and recover the money for the benefit of all creditors. On the other hand, when a creditor invokes § 523(a), he does not seek to bring the money back to the estate to divvy up among the creditors. Rather, the creditor wants the recipient to keep the money so *1351 that the creditor alone can collect it after the bankruptcy court excepts the corresponding debt from discharge under § 523(a)(2)(A). Simply put, a Trustee action cannot preempt the field of fraudulent transfer actions because creditors are playing on a different field. See Husky, 578 U.S. at 364, 136 S.Ct. 1581 (rejecting Ritz's argument that allowing creditors to raise "actual fraud" claims under § 523(a)(2)(A) makes § 727(a)(2) redundant because "[a]lthough the two provisions could cover some of the same conduct, they are meaningfully different").

3. To be clear, we are not saying that the settlement of the Trustee's § 544(b) avoidance claim is meaningless. As PRN concedes, Cole may have a viable argument for satisfaction or double recovery if (a) PRN succeeds in obtaining a judgment that requires Cole to pay COLP's portion of the SunTrust contribution debt and (b) Cole can show that PRN included that debt as part of the proof of claim that Cole's estate paid

in the underlying bankruptcy case. But we leave those 'ifs' for another day. Today, our holding is limited: The Trustee's § 544(b) avoidance action does not preempt Cole's § 523(a) (2)(A) action for a discharge exception.

To sum up, Congress gave PRN the right to request an exception of COLP's contribution debt, if PRN can prove that Cole fraudulently obtained COLP's money, and as a result, became responsible for COLP's contribution debt. PRN has pleaded facts that, if proved, meet these requirements. And the Trustee's action to avoid the same fraudulent transfer does not preempt PRN's right to seek a discharge exception.

Because the bankruptcy court dismissed PRN's claim based on non-viability and lack of standing, the bankruptcy court did not rule on the merits of Cole's motion for summary judgment. We thus remand the case for the bankruptcy court to determine in the first instance whether any facts material to Count 3 are genuinely disputed, and if not, whether Cole is entitled to judgment on Count 3. *See* Fed. R. Civ. P. 56(a).

IV. CONCLUSION

We **REVERSE** the bankruptcy court's order granting summary judgment for Cole on Count 3 and **AFFIRM** the court's orders granting judgment for Cole on all other counts. We **REMAND** the case to the district court for further proceedings consistent with this opinion.

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