841 F.3d 1
United States Court of Appeals, First Circuit.

In re: Richard D. Crawford, Debtor.
Premier Capital, LLC, Plaintiff, Appellee,
v.
Richard D. Crawford, Defendant, Appellant.

No.
16
-
1285
|
October 25, 2016

Synopsis

Background: Creditor brought adversary proceeding to deny debtor a Chapter 7 discharge on fraudulent transfer/concealment, "false oath," and other theories. The United States Bankruptcy Court for the District of Massachusetts, Frank J. Bailey, J., 531 B.R. 275, entered judgment in favor of creditor, and debtor appealed. The District Court, Leo T. Sorokin, J., affirmed. Debtor appealed.

Holdings: The Court of Appeals, McConnell, District Judge, sitting by designation, held that:

[1] bankruptcy court did not abuse its discretion in findingthat unpled claim, regarding omission of retirement account from debtor's schedule of assets, was tried with implied consent of parties;

[2] bankruptcy court did not improperly place initialburden of proof on debtor; and

[3] while debtor disclosed the total value of accountsthat he had with financial institution, his failure to schedule, as separate asset apart from the 401(k) employee retirement account that he had at this institution, a separate retirement account was in nature of "material" false oath, of kind warranting denial of his discharge.

Affirmed.

West Headnotes (23)

[1] **Bankruptcy**
Clear error

On appeal from district court's affirmance of decision of bankruptcy court, the Court of Appeals reviews bankruptcy court's findings of fact for clear error, and will not set such findings aside unless it has a strong, unyielding belief that mistake was made.

Cases that cite this headnote

[2] **Bankruptcy**
Conclusions of law; d e novo review

On appeal from district court's affirmance of decision of bankruptcy court, the Court of Appeals reviews bankruptcy court's conclusions of law de novo.

Cases that cite this headnote

[3] **Bankruptcy**
Discretion

Bankruptcy court's determination as to whether an unpled claim was tried with parties' implied consent is reviewed for abuse of discretion.

Cases that cite this headnote

[4] **Bankruptcy**
Conclusions of law; d e novo review

On appeal from district court's affirmance of decision of bankruptcy court, the Court of Appeals accords no special deference to district court's determinations, notwithstanding that the Court of Appeals is the second-in-time reviewer.

Cases that cite this headnote

[5] **Federal Civil Procedure**
Issues tried by consent of parties

A party can give implied consent to the litigation of an unpleaded claim in two ways: by treating a claim introduced outside the complaint as having been pleaded, either through the party's effective

engagement of the claim or through his silent acquiescence; or by acquiescing during trial in the introduction of evidence which is relevant only to that issue. Fed. R. Civ. P. 15(b).

1 Cases that cite this headnote

[6] **Bankruptcy**
Pleading

In proceeding to deny debtor a Chapter 7 discharge based on his false oaths, bankruptcy court did not abuse its discretion in finding that unpled claim, regarding omission of retirement account from debtor's schedule of assets, was tried with implied consent of parties, where debtor did not object to introduction of evidence of his failure to schedule this retirement account, but responded on merits in arguing that asset was not omitted with requisite fraudulent intent and was insufficient to support denial of discharge. 11 U.S.C.A. § 727(a)(4)(A); Fed. R. Civ. P. 15(b).

Cases that cite this headnote

[7] **Bankruptcy**
Particular grounds for objection to discharge
Bankruptcy
False oath or account

In proceeding to deny debtor a discharge based on his false oaths, plaintiff bears burden of establishing each element of prima facie case by preponderance of the evidence, whereupon the burden shifts to debtor to come forward with evidence rebutting plaintiff's prima facie case. 11 U.S.C.A. § 727(a)(4)(A).

1 Cases that cite this headnote

[8] **Bankruptcy**
Particular grounds for objection to discharge

Bankruptcy court's statement that Chapter 7 debtor did not deny the materiality of omission from schedule of assets was merely in nature of comment on debtor's failure to rebut one of the elements of objecting creditor's prima facie case, and was insufficient to show that bankruptcy court had improperly placed initial burden of proof on debtor in proceeding brought by creditor to deny him a discharge based on his false oaths. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[9] **Bankruptcy**
Protection Against Discrimination or Collection Efforts in General; ‘ Fresh Start.‘

Bankruptcy Code limits the opportunity for a completely unencumbered new beginning to the honest but unfortunate debtor. 11 U.S.C.A. § 727(a).

Cases that cite this headnote

[10] **Bankruptcy**
False Oath or Account

“False oath” discharge exception purports to prevent debtors who play fast and loose with their assets or with reality of their affairs from seeking refuge under the Bankruptcy Code. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[11] **Bankruptcy**
Dischargeable Debtors

Bankruptcy is an essentially equitable remedy, and right to discharge should ordinarily be construed liberally in favor of debtor; however, if debtor's conduct falls squarely within a discharge exception, then this policy of liberally construing debtor's right to discharge does not apply. 11 U.S.C.A. § 727(a).

Cases that cite this headnote

[12] **Bankruptcy**
False Oath or Account

In order for bankruptcy court to deny debtor a discharge based on his false oath, court must find that debtor: (1) knowingly and fraudulently made a false oath, (2) relating to a material fact. 11 U.S.C.A. § 727(a)(4)(A).

1 Cases that cite this headnote

[13] **Bankruptcy**

Errors on and omissions from schedules

When debtor files her schedules, she makes the equivalent of an oath, of kind required by "false oath" discharge exception. 11 U.S.C.A. § 727(a)(4)(A); Fed. R. Bankr. P. 1008.

1 Cases that cite this headnote

[14] **Bankruptcy**

Requisites in general

Debtor has duty to prepare bankruptcy schedules accurately and with reasonable particularization under the circumstances; however, debtor is required to do only enough itemizing to enable trustee to determine whether to investigate further.

Cases that cite this headnote

[15] **Bankruptcy**

Errors on and omissions from schedules

By omitting retirement account from his schedule of assets, Chapter 7 debtor made a "false oath," within meaning of discharge exception. 11 U.S.C.A. § 727(a)(4)(A).

1 Cases that cite this headnote

[16] **Bankruptcy**

False Oath or Account

False oath is "material," as required by discharge exception, if its subject matter bears a relationship to debtor's business transactions or estate, or concerns discovery of assets, business dealings, or the existence and disposition of debtor's property. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[17] **Bankruptcy**

False Oath or Account

Requirement that, in order to provide basis for denial of debtor's discharge, his false oath must be "material" is a fairly low threshold. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[18] **Bankruptcy**

False Oath or Account

Valuation does not determine the materiality of debtor's false oath, for denial-of-discharge purposes, and disclosure of asset's value does not dispense with materiality question. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[19] **Bankruptcy**

Property

Regardless of whether a creditor may reach asset, debtor still must disclose that asset's existence.

Cases that cite this headnote

[20] **Bankruptcy**

False Oath or Account

Materiality of debtor's false oath, for purposes of discharge exception, does not depend upon whether the falsehood has in fact been detrimental to creditors. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[21] **Bankruptcy**

Errors on and omissions from schedules

While Chapter 7 debtor disclosed the total value of accounts that he had with financial institution, his failure to schedule, as separate asset apart from the 401(k) employee retirement account that he had at this institution, a separate retirement account that he had at this same institution was in nature of "material" false oath, of kind warranting denial of his discharge. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

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[22] Bankruptcy

False Oath or Account

Bankruptcy disclosures are not meant to create a trap for the unwary, and one false step by debtor in disclosing assets or transactions will not lead to draconian results. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[23] Bankruptcy

Property

Creditors have a right to investigate the history of a debtor's asset, and if a debtor fails to disclose the existence of an asset, then a creditor may not be able to engage in due diligence; creditors are entitled to judge for themselves what will benefit, and what will prejudice, them.

Cases that cite this headnote

***3** APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MASSACHUSETTS [Hon. Leo T. Sorokin, U.S. District Judge]

Attorneys and Law Firms

Emily C. Shanahan, with whom Mark S. Furman, John D. Finnegan, and Tarlow, Breed, Hart & Rodgers, P.C., Boston, MA, were on brief, for appellant.

Douglass C. Lawrence, Dover, MA, with whom Thomas H. Curran, Peter Antonelli, and Curran Antonelli, LLP were on brief, for appellee.

Before Thompson and Barron, Circuit Judges, and McConnell,[*] District Judge.

Opinion

***4** MCCONNELL, District Judge.

A bankruptcy court denied Richard D. Crawford's petition for bankruptcy, in part, because Crawford omitted the existence of his Cash Balance Plan ("CBP"), a retirement account, from his Schedule B filing. While Crawford omitted the existence of the account, he disclosed the account's value through inclusion with a second retirement account, a 401(k). On appeal, this Court considers whether omitting an asset's name but including the asset's value on a Schedule B form clears the materiality threshold for a false oath claim under 11 U.S.C. § 727(a)(4)(A). For the reasons set out below, we affirm.

I. Background

The genesis of this bankruptcy case dates back to a loan that Crawford personally guaranteed. Crawford, a financially sophisticated individual, works in the banking industry as a mortgage originator at Wells Fargo. In 1987, Oak Street Realty Trust ("Oak Street"), a company in which Crawford has an 80% interest, received a $250,000 loan from Amoskeag Bank ("Amoskeag") secured by Oak Street property. In 1989, through a Change in Terms Agreement, Crawford guaranteed the loan in his individual capacity. After the loan matured, neither Oak Street nor Crawford paid the balance. The FDIC, acting as liquidating agent for Amoskeag, assigned Amoskeag's interest to Tenth RMA Partners, L.P. ("RMA"). RMA obtained a judgment against Crawford in the amount of $388,753.01 and then assigned its interest to Premier who sought and received a $456,774.04[1] execution on the judgment from the Middlesex Superior Court. Save for the $7,030.68 that Premier obtained from wage garnishments, the execution remains in full force.

Reaching a financial impasse with liabilities far exceeding assets, Crawford petitioned for bankruptcy. He subsequently filed his Schedules and Statement of Financial Affairs ("SOFA"). Two weeks later, Crawford filed an amended SOFA. With Crawford's fresh start in sight, Premier thwarted Crawford's discharge of debt through the filing of the instant action. Two claims formed the basis for the bankruptcy court's disposition: (1) the making of a false oath in violation of 11 U.S.C. § 727(a)(4)(A) and (2) the intentional concealment of property in violation of 11 U.S.C. § 727(a)(2)(A). Because we affirm on the false oath count, we do not reach the merits of the unlawful concealment claim.

At the time Crawford petitioned for bankruptcy, he had two retirement accounts with Wells Fargo, a 401(k) account and a CBP. Wells Fargo provides quarterly statements to

Crawford with the heading “401(k) Plan and Cash Balance Plan.” On this statement, the two accounts are listed separately and with separate balances, but the statement also contains a cumulative amount reported under the label “Total Retirement Accounts.”

Schedule B, item 12, requires an individual filing for bankruptcy to disclose “[i]nterests in IRA, ERISA, Keough, or other pension or profit sharing plans” and to “[g]ive particulars.” In addition, this form contains a column for the description and location of property as well as the current value of the property. After consulting with counsel, Crawford filed his Schedule B, item 12, which listed “401(k) with Wells Fargo” under the description and “$148,000” ***5** under the value. Crawford's form made no mention of his CBP.

Premier's complaint made a general allegation of a false oath in Crawford's Schedules and Statement of Financial Affairs. The CBP, though not mentioned in the complaint as the basis for a false oath claim, became a topic of the trial on the second day of the three day trial. At trial, Premier introduced Exhibit 847–1, which contained Crawford's quarterly statements with Wells Fargo. Crawford objected to the introduction of the exhibit under Rule 403, arguing that the statements were cumulative. The bankruptcy court overruled Crawford's sole objection on the matter. On direct examination, Premier questioned Crawford on whether he had a CBP that he failed to list on his Schedule B.[2] Evasive at first, Crawford retorted, “I gave all this information to [my former attorney].” Eventually, Crawford admitted that his CBP is a retirement account and he failed to include it in his Schedule B. Pressing further, Premier directly asked why Crawford failed to list the CBP. To this, Crawford equivocated, “I don't have a good answer for you sir.” On cross-examination, Crawford's counsel presented Crawford with Exhibit 847–1 and asked whether he disclosed the amount listed on the quarterly statement. Crawford affirmed that he had. On redirect, Premier once again questioned Crawford on his failure to list his CBP. Specifically, Premier asked, “Is it not separated out as a separate plan on your statement, the CBP? Is it not?” “I think it's a different heading. I agree; yes, sir,” Crawford answered.

In Premier's post trial brief, Premier argued that by failing to disclose his interest in the CBP, Crawford committed a false oath in violation of 11 U.S.C. § 727(a)(4)(A). In Crawford's Proposed Findings of Fact and Conclusion of Law, again contesting the disclosure, Crawford reasoned that he did disclose his CBP, or if he did fail to disclose, that failure was not the product of fraudulent intent. At closing arguments, both parties engaged the merits of the false oath claim at issue. Crawford averred, “So while the CBP wasn't separately listed on his schedules, the amount in it was included in the 401K amount that was reflected on Mr. Crawford's schedule....”

The bankruptcy court found Crawford “less than credible” based on numerous misrepresentations and evasive answers. The court ruled that while the claim of a false oath by omission of the CBP was not raised in Premier's complaint, Crawford impliedly consented to the trial of the charge. Additionally, the court concluded that Crawford's failure to include his CBP in his Schedule B, item 12, amounted to a false oath. Finding Crawford's veracity suspect, the court reasoned that the CBP and 401(k) are separate accounts and that Crawford believed the accounts were separate when he filed his Schedule B. Premier Capital, LLC v. Crawford (In re Crawford), 531 B.R. 275 (Bankr. D. Mass. 2015). On appeal, the District of Massachusetts affirmed the false oath claim. Premier Capital, LLC v. Crawford (In re Crawford), No. 15–12726 (D. Mass. Feb. 26, 2016).

Now, Crawford raises several errors with the district court's decision: the finding of implied consent on Crawford's part to try the omission of the CBP Plan from Schedule B, the improper application of the burden-shifting method of proof for false-oath claims, and the determination that the omission of the CBP was a false oath and material.

Antilles Cement Corp., 670 F.3d at 319 (alteration in original) (quoting Rodriguez v. Doral Mortgage Corp., 57 ***6 II. Standard of Review** F.3d 1168, 1172 (1st Cir. 1995)).

[1] [2] [3] [4] We review the bankruptcy court's findings of fact for clear error. Davis v. Cox, 356 F.3d 76, 82 (1st Cir. 2004). We will not set aside the trier's findings absent a “strong, unyielding belief that a mistake was made.” Carp v. Carp (In re Carp), 340 F.3d 15, 22 (1st Cir. 2003). In contrast, we review the

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bankruptcy court's conclusions of law de novo, Davis, 356 F.3d at 82, and review issues of implied consent for abuse of discretion. Antilles Cement Corp. v. Fortuno, 670 F.3d 310, 319 (1st Cir. 2012). "Notwithstanding the fact that we are the second-in-time reviewers, we cede no special deference to the district court's determinations." Carp, 340 F.3d at 21.

III. Analysis

Before this Court may reach the merits of the false oath claim, we must first consider two threshold issues— implied consent and improper burden shifting.

A. Implied Consent

[5] **[6]** Premier's complaint and pre-trial filings never identified the omission of the CBP as forming the basis of a false oath claim. However, "Federal Rule of Civil Procedure 15(b) allows an unpleaded claim to be considered when the parties' conduct demonstrates their express or implied consent to litigate the claim." Antilles Cement Corp., 670 F.3d at 319. "When an issue not raised by the pleadings is tried by the parties' express or implied consent, it must be treated in all respects as if raised in the pleadings." Fed. R. Civ. P. 15(b)(2).[3]

> A party can give implied consent to the litigation of an unpleaded claim in two ways: by treating a claim introduced outside the complaint 'as having been pleaded, either through [the party's] effective engagement of the claim or through his silent acquiescence'; or by acquiescing during trial 'in the introduction of evidence which is relevant only to that issue.'

At trial, Premier introduced Crawford's quarterly statements with Wells Fargo and examined Crawford regarding the omission of the CBP from his Schedule B. While Crawford objected to the admission of the statements under Rule 403, he clarified that the duplicative nature of the documents formed the basis for his objection. See Conjugal P'ship v. Conjugal P'ship, 22 F.3d 391, 400–01 (1st Cir. 1994) ("One sign of implied consent is that issues not raised by the pleadings are presented and argued without proper objection by opposing counsel." (internal quotation marks omitted) (quoting In re Prescott, 805 F.2d 719, 725 (7th Cir. 1986))). On multiple occasions, Premier pointedly asked Crawford why he failed to include his CBP on his Schedule B. Crawford responded without objection. In fact, on cross-examination, Crawford's counsel attempted to rebut Premier's questions by pointing out that Crawford disclosed the value of the asset. Both Crawford and Premier continued to contest the issue in post-trial memoranda and closing arguments. Because Crawford failed to object to the trial of an unpleaded claim and engaged the merits of the claim, this Court cannot say that the bankruptcy court abused its discretion by finding Crawford impliedly consented.

B. Burden Shifting

[7] **[8]** Crawford next asserts that both the bankruptcy court and district court ***7** prematurely applied the burden-shifting framework, saddling him (to quote his brief) with the burden of proving "that his disclosure was not false and that it was not material without first finding that Premier ha[d] made out its prima facie case." Under § 727(a)(4)(A), the plaintiff bears the burden to establish each element of a prima facie case by a preponderance of the evidence. In re Mascolo, 505 F.2d 274, 276 (1st Cir. 1974). Once that party puts forth a prima facie case, the burden shifts to the debtor who must then come forth with evidence rebutting the offense. Id.

The bankruptcy court recited the correct burden-shifting framework. Specifically, the court stated:

> The burden of proof is on the party objecting to discharge.... *Tully* indicates, however, that 'once it reasonably appears that the oath is false, the burden falls upon the [debtor] to come forward with evidence that he has not committed the offense charged.' This language does not shift the burden of proof or nullify the need to prove knowledge of falsity and fraudulent intent. Rather, it establishes that a false oath may itself be sufficient to establish knowledge of falsity and fraudulent intent.

Premier Capital, LLC v. Crawford (In re Crawford), 531 B.R. 275, 299 (Bankr. D. Mass. 2015) (alteration in original) (citations omitted). Nothing in the bankruptcy court's memorandum of decision leads us to believe that the court improperly placed the onus on Crawford prior to the establishment of a prima facie case. The one sentence that Crawford points to in the

bankruptcy court's memorandum of decision—"[Crawford] does not deny, and I find, that [the omission of the CBP] was material"— proves unavailing because that sentence merely explains that Crawford did not attempt to rebut the materiality of the omission. Id. at 307. Moreover, Crawford's position is inapposite given the bankruptcy court's statement that "[t]he party objecting to the discharge must show that (i) the debtor made an oath (ii) that was false and (iii) related to a material fact in the case (iv) knowingly and (v) fraudulently." Id. at 306.

In addition, Crawford reasons that improper burden shifting occurred because, in Crawford's words, Premier failed to present any evidence of materiality. Despite Crawford's assertion to the contrary, Premier put forth evidence proving the materiality of the CBP omission. Namely, Premier introduced Crawford's quarterly 401(k) and CBP statements into evidence and examined Crawford regarding the omission of the CBP. Crawford fails to point to language in the bankruptcy court's disposition that indicates improper application of the burden-shifting framework, and Premier presented evidence sufficient to make out a prima facie case; therefore, we do not find that the bankruptcy court improperly shifted the burden to Crawford.

C. False Oath

[9] [10] [11] The Bankruptcy Code "limits the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor.' " Grogan v. Garner, 498 U.S. 279, 286–87, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991) (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244, 54 S.Ct. 695, 78 L.Ed. 1230 (1934)). In considering a denial of discharge for a false oath, two competing considerations are at play. On the one hand, § 727(a)(4)(A) purports to prevent debtors who "play fast and loose with their assets or with the reality of their affairs" from seeking refuge under the Bankruptcy Code. Boroff v. Tully (In re Tully), 818 F.2d 106, 110 (1st Cir. 1987). On the other hand, "bankruptcy is an essentially equitable remedy," so "the statutory ***8** right to a discharge should ordinarily be construed liberally in favor of the debtor." Id. Where a claim falls squarely within one of the Bankruptcy Code's exceptions—and Premier's false oath claim certainly does—the liberal construction of the right to discharge does not apply. Martin v. Bajgar (In re Bajgar), 104 F.3d 495, 498 n.1 (1st Cir. 1997).

[12] "The court shall grant the debtor a discharge, unless ... the debtor knowingly and fraudulently, in or in connection with the case ... made a false oath or account...." 11 U.S.C. § 727(a)(4)(A). In order for § 727(a)(4)(A) to form the basis for denying discharge, the Court must find that the debtor "(i) knowingly and fraudulently made a false oath, (ii) relating to a material fact." Boroff, 818 F.2d at 110. On appeal, Crawford advances arguments encompassing the false oath and material fact elements.[4]

[13] **[14]** When a debtor files her Schedules, she does so under the equivalent of an oath. Fed. R. Bankr. P. 1008; Perry v. Warner (In re Warner), 247 B.R. 24, 26 (1st Cir. BAP 2000). A debtor has a duty to prepare schedules accurately and with "reasonable particularization under the circumstances." Donarumo v. Furlong (In re Furlong), 660 F.3d 81, 87 (1st Cir. 2011) (quoting In re Mohring, 142 B.R. 389, 394–95 (Bankr. E.D. Cal. 1992), aff'd, 153 B.R. 601 (9th Cir. BAP 1993), aff'd, 24 F.3d 247 (9th Cir. 1994)) (internal quotation marks omitted). "[A] debtor is required only to 'do enough itemizing to enable the trustee to determine whether to investigate further.'" Id. at 87 (quoting Payne v. Wood, 775 F.2d 202, 207 (7th Cir. 1985)).

[15] By omitting an account from his Schedule B, Crawford made a false oath. See Harrington v. Donahue (In re Donahue), BAP No. NH 11–026, 2011 WL 6737074, at *11 (1st Cir. BAP Dec. 20, 2011) ("[W]hen a debtor omits a transaction from his Statement of Financial of Affairs, he has made a false oath."). Schedule B, item 12, instructed Crawford to disclose his "[i]nterests in IRA, ERISA, Keough, or other pension or profit sharing plans" and to "[g]ive particulars." While Crawford listed his 401(k) account with Wells Fargo and included the combined value of his 401(k) and CBP, Crawford failed to list the existence of his CBP on the form, as required by Schedule B, item 12.

[16] **[17] [18]** A false oath is material if its subject matter "bears a relationship to the bankrupt's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of his property." Boroff, 818 F.2d at 111 (quoting Chalik v. Moorefield (In re Chalik), 748 F.2d 616, 618 (11th Cir. 1984)) (internal quotation marks omitted). "[T]he threshold

to materiality is fairly low." Lussier v. Sullivan (In re Sullivan), 455 B.R. 829, 839 (1st Cir. BAP 2011) (quoting Cepelak v. Sears (In re Sears), 246 B.R. 341, 347 (8th Cir. BAP 2000)) (internal quotation marks omitted). Like many of our sister courts, we have rejected the notion that valuation determines materiality.[5] Boroff, 818 F.2d at 110 n.4. Therefore, ***9** the disclosure of an asset's value does not dispense with the materiality question.

[19] [20] Regardless of whether a creditor may reach an asset, the debtor still must disclose that asset's existence. Daniels v. Agin, 736 F.3d 70, 84 (1st Cir. 2013). After all, the creditor, not the debtor, is in the best position to determine what may or may not affect that creditor. As articulated in In re Mascolo, "[T]he materiality of the false oath will not depend upon whether in fact the falsehood has been detrimental to the creditors." 505 F.2d 274, 278 (1st Cir. 1974) (quoting In re Slocum, 22 F.2d 282, 285 (2d Cir. 1927)) (internal quotation marks omitted). Thus, we need not analyze the character of the asset or whether creditors could recover from the asset.

[21] Critically for our purposes, when it comes to materiality, we distinguish an asset from an asset's value.

Footnotes

* Of the District of Rhode Island, sitting by designation.

Knowledge of an asset's value alone does little to forewarn creditors and the court of unscrupulous dealings. For this reason, the discovery of an asset's existence, as in the case of the CBP, clears the threshold for materiality. Boroff, 818 F.2d at 111. Listing one retirement account held with a financial institution does not signal the existence of a second account held with that same institution. To hold otherwise would be at odds with the principles of a rule rooted in honest disclosures. Our decision today, follows our ruling in Daniels, which addressed a similar scenario. 736 F.3d at 82–83. Much like the matter before this Court, in Daniels, the debtor failed to list two IRA accounts in his Schedule B and instead included the value with that of the reported profit-sharing plan. Id. at 74. Despite disclosing the value, we regarded the excluded IRA information as material. Id. at 83.

[22] [23] Bankruptcy disclosures are not meant to create a trap for the unwary,[6] and we see no perverse result in affirming the denial of Crawford's bankruptcy. By omitting the existence of the CBP, a creditor would not otherwise know of the plan's existence. Creditors have a right to investigate the history of a debtor's asset,[7] and if a debtor fails to disclose the existence of an asset, then a creditor may not be able to engage in due diligence.

IV. Conclusion

We affirm the district court's ruling on the § 727(a)(4)(A) claim; therefore, we do not reach the merits of the § 727(a)(2)(A) claim.

Affirmed.

All Citations

841 F.3d 1

1 Premier alleges that at the time Crawford filed for bankruptcy, Crawford owed an amount in excess of $725,000. 2 Crawford objected once arguing that "this assumes facts not in evidence." Upon elaboration, he contended that the Schedules were prepared prior to receiving the new quarterly statement.

3 Rule 15 of the Federal Rules of Civil Procedure apply in adversary proceedings in bankruptcy court, under Rule 7015 of the Federal Rules of Bankruptcy Procedure.

4 Crawford does not raise error with the intent component—"knowingly and fraudulently." § 727(a)(4)(A).

5 E.g., Palatine Nat'l Bank v. Olson (In re Olson), 916 F.2d 481, 484 (8th Cir. 1990) ("While we are not prepared to say that value is irrelevant to materiality, we are certain that it is not determinative."); Chalik, 748 F.2d at 618 ("The recalcitrant debtor may not escape a section 727(a)(4)(A) denial of discharge by asserting that the admittedly omitted or falsely stated information concerned a worthless business relationship or holding; such a defense is specious." (citations omitted)); see also U.S. Trustee v. Garland (In re Garland), 417 B.R. 805, 814 (10th Cir. BAP 2009) ("[M]ateriality is not defeated by the fact that the undisclosed property interests are determined to be without value."); cf. Fogal Legware of Switz., Inc. v. Wills (In re Wills), 243 B.R. 58, 63 (9th Cir. BAP 1999) ("A false statement or omission may be material even if it does not cause direct financial prejudice to creditors.").

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6 One false step does not lead to draconian results. See, e.g., Dotson v. Cogswell (In re Cogswell), 462 B.R. 28, 35 (Bankr. D. Mass. 2012) (misstating the year of a boat and misstating an inconsequential sum on a credit card statement are "harmless errors"); see also Steele v. Boutiette (In re Boutiette), 168 B.R. 474, 482 (Bankr. D. Mass. 1994) ("[A] debtor [should] not be put at risk that discharge will be denied by a mischaracterization which is esoteric.").

7 "[C]reditors are entitled to judge for themselves what will benefit, and what will prejudice, them." Harrington v. Mazzone (In re Mazzone), 510 B.R. 439, 445 (Bankr. D. Mass. 2014) (quoting JP Morgan Chase Bank, N.A. v. Koss (In re Koss), 403 B.R. 191, 213 (Bankr. D. Mass. 2009)) (internal quotation marks omitted); Chalik v. Moorefield (In re Chalik), 748 F.2d 616, 618 (11th Cir. 1984).

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839 F.3d 63
United States Court of Appeals, First Circuit.

In re: Patrick J. Hannon; Elizabeth Hannon, Debtors.
Patrick J. Hannon, Plaintiff, Appellant,
v.
ABCD Holdings, LLC; ABC&D Recycling, INC.; Ware Real Estate, LLC, Defendants, Appellees.

No. 15–2269
|
October 7, 2016

Synopsis
Background: Creditors brought adversary proceeding to deny debtor a Chapter 7 discharge based on "false oaths" that he had made in monthly operating reports filed while case was proceeding as individual Chapter 11 case. Creditors moved for summary judgment. The United States Bankruptcy Court for the District of Massachusetts, William C. Hillman, J., 512 B.R. 1, granted motion, and debtor appealed. The District Court, Denise J. Casper, J., affirmed. Debtor appealed.

[Holding:] The Court of Appeals, McAuliffe, District Judge, sitting by designation, held that debtor, in identifying on his monthly operating reports only about $4,200 of the at least $19,323.22 in disbursements made by his company over the relevant time period for his personal benefit, acted with at least cavalier indifference and a pattern of disdain for the truth, of kind sufficient to satisfy intent element of "false oath" discharge exception.

Affirmed.

West Headnotes (21)

[1] Bankruptcy
Scope of review in general

On appeal from district court's decision in its bankruptcy appellate capacity, the Court of Appeals cedes no special deference to determinations of the district court and instead assesses the bankruptcy court's decision directly.

Cases that cite this headnote

[2] Bankruptcy
Conclusions of law; d e novo review

Bankruptcy court's grant of summary judgment is reviewed de novo.

Cases that cite this headnote

[3] Bankruptcy
Judgment or Order

Legal standards traditionally applicable to motions for summary judgment apply without change in bankruptcy proceedings. Fed. R. Civ. P. 56; Fed. R. Bankr. P. 7056.

Cases that cite this headnote

[4] Federal Civil Procedure
Presumptions

On motion for summary judgment, all reasonable inferences from the facts must be drawn in the manner most favorable to nonmovant.

Cases that cite this headnote

[5] Bankruptcy
False Oath or Account

Debtor may be denied a discharge on "false oath" theory only if he (1) knowingly and fraudulently made a false oath, (2) relating to a material fact. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[6] Bankruptcy
Equitable powers and principles

Bankruptcy is an essentially equitable remedy, and equitable principles govern the exercise of bankruptcy jurisdiction.

Cases that cite this headnote

[7] Bankruptcy
Dischargeable Debtors

Debtor's statutory right to a discharge should ordinarily be construed liberally in favor of debtor. 11 U.S.C.A. § 727(a).

Cases that cite this headnote

[8] **Bankruptcy**
Grounds for Denial of Discharge

Reasons for denying debtor a discharge must be real and substantial, not merely technical and conjectural. 11 U.S.C.A. § 727(a).

Cases that cite this headnote

[9] **Bankruptcy**
Grounds for Denial of Discharge
Bankruptcy
False Oath or Account

Purpose of certain discharge exceptions, like the "false oath" discharge exception, is to make certain that those who seek the shelter of bankruptcy do not play fast and loose with their assets or with the reality of their affairs, and to ensure that complete, truthful, and reliable information is put forward at the outset of the proceedings, so that decisions can be made by parties in interest based on fact rather than fiction. 11 U.S.C.A. § 727(a)(4) (A).

Cases that cite this headnote

[10] **Bankruptcy**
False Oath or Account

Successful functioning of bankruptcy law hinges both upon the bankrupt's veracity and his willingness to make a full disclosure.

Cases that cite this headnote

[11] **Bankruptcy**
Presentation of grounds for review

While statements which individual Chapter 11 debtor made on his monthly operating reports upon certification that they were true and correct to the best of his knowledge, information and belief were likely statements under oath, for purposes of "false oath" discharge exception, question of whether they were in fact statements under oath was forfeited as issue on appeal from bankruptcy court order denying debtor a discharge, where debtor raised issue for first time on appeal. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[12] **Bankruptcy**
Intent
Bankruptcy
Effect; p roceedings in converted case

Debtor whose individual Chapter 11 case was converted to one under Chapter 7, in identifying on his monthly operating reports only about $4,200 of the at least $19,323.22 in disbursements made by his company over the relevant time period for his personal benefit, acted with at least cavalier indifference and a pattern of disdain for the truth, of kind sufficient to satisfy intent element of "false oath" discharge exception, notwithstanding that he had only a high school education and relied on his attorney to complete reports; while lacking any formal training in financial reporting, debtor, as owner and operator of two business, was hardly unsophisticated and demonstrated his awareness of need to report disbursements that company made on his behalf by selectively reporting only a small percentage of those disbursements. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[13] **Bankruptcy**
Intent
Bankruptcy
False Oath or Account

Debtor "knowingly and fraudulently" makes a false oath, as required by "false oath" discharge exception, if he knows the truth and nonetheless willfully and intentionally swears to what is false. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[14] **Bankruptcy**
Intent

Reckless indifference to the truth is treated as the functional equivalent of fraud, for purposes of "false oath" discharge exception. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[15] **Federal Civil Procedure**
Matters Affecting Right to Judgment

Courts use special caution in granting summary judgment as to intent, since intent is often proven by inference, and since, on motion for summary judgment, all reasonable inferences must be drawn in favor of nonmoving party.

Cases that cite this headnote

[16] **Federal Civil Procedure**
Matters Affecting Right to Judgment
Federal Civil Procedure
Weight and sufficiency

Summary judgment may be warranted even as to such elusive elements such as a party's motive or intent where the non-moving party rests merely upon conclusory allegations, improbable inferences, and unsupported speculation.

Cases that cite this headnote

[17] **Bankruptcy**
Particular grounds for objection to discharge

Debtor's honest confusion or lack of understanding may weigh against an inference of fraudulent intent in proceeding to deny him a discharge based on his knowing and fraudulent false oaths. 11 U.S.C.A. § 727(a)(4) (A).

Cases that cite this headnote

[18] **Bankruptcy**
False Oath or Account

Reliance on advice of counsel is no defense in proceeding to deny debtor a discharge based on his false oaths, where the deficiencies in disclosures made on documents filed with court should have been evident to debtor. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[19] **Bankruptcy**
False Oath or Account

Debtor cannot, merely by playing ostrich and burying his head deeply enough in the sand, disclaim all responsibility for statements which he has made under oath.

Cases that cite this headnote

[20] **Bankruptcy**
False Oath or Account

False oath is "material," as required by discharge exception, if it bears a relationship to debtor's business transactions or estate, or concerns the discovery of assets, business dealings, or existence and disposition of property. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[21] **Bankruptcy**
False Oath or Account
Bankruptcy
Effect; p roceedings in converted case

Fraudulent nondisclosures that prevented parties in interest from accurately assessing the viability of individual Chapter 11 debtor's reorganization or understanding debtor's true financial condition were "material," as required to support denial of debtor's discharge on "false oath" theory after case was converted to one under Chapter 7. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

***65** APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MASSACHUSETTS [Hon. Denise J. Casper, U.S. District Judge]

Attorneys and Law Firms

Matthew R. Johnson, with whom Joshua M. Wyatt and Devine, Millimet & Branch, P.A. were on brief, for appellant.

Joel E. Faller, with whom McLaughlin Brothers, P.C. was on brief, for appellees.

Before Kayatta and Barron, Circuit Judges, McAuliffe,[*] District Judge.

Opinion

McAULIFFE, District Judge.

Patrick J. Hannon ("Hannon") appeals from the entry of summary judgment denying his petition for a discharge in bankruptcy. See 11 U.S.C. § 727(a)(4)(A). The bankruptcy court denied the discharge after concluding that Hannon made false material statements with respect to disbursements made on his behalf by third parties during the bankruptcy proceeding. The district court affirmed the bankruptcy court's entry of summary judgment, and we affirm as well.

I. Background

A. Factual Background In May of 2012, Hannon and his wife, Elizabeth, sought protection from their creditors by filing a voluntary bankruptcy petition under Chapter 11 of the Bankruptcy

Code.[1] The Hannons reported total assets of about $6 million, and liabilities of approximately $10.4 million, which included a disputed tax debt of more than $7 million.

Hannon owned and operated a recycling and scrap metal company, ABC&D Recycling, Inc. ("ABC&D Recycling"), as well as a real estate company, Ware Real Estate, LLC ("Ware Real Estate"), which ***66** held title to the land on which ABC&D Recycling was located. The Hannons estimated that monthly expenses necessary to support their family during the bankruptcy process would average about $13,180, and noted that the income required to pay those expenses would come from ABC&D Recycling's ongoing operations while Hannon served as debtor-in-possession.

ABC&D Recycling and Ware Real Estate

Hannon bought ABC&D Recycling and Ware Real Estate with the help of an attorney named George McLaughlin, Esq., who had previously represented Hannon. McLaughlin owned a financing company, Bright Horizon Finance, LLC ("Bright Horizon"), which loaned Hannon the necessary funds. Bright Horizon's loan terms included warrant rights, affording it the option to purchase a 50.1 percent interest in each company. On June 21, 2012, after the Hannons filed for bankruptcy protection, Bright Horizon assigned its warrant to ABCD Holdings, LLC ("ABCD Holdings"), another company controlled by McLaughlin, and, on July 17, 2012, ABCD Holdings exercised those warrant rights, thereby obtaining a 50.1 percent ownership interest in both Ware Real Estate and ABC&D Recycling.

A few weeks earlier, on June 27, 2012, McLaughlin, suspecting that business funds were being diverted by Hannon for unauthorized purposes, obtained an ex parte temporary restraining order from the Suffolk County Superior Court. That order temporarily barred Hannon from ABC&D Recycling's premises. On July 2, 2012, however, that order was modified to allow Hannon to resume operational control over the business. A short time later, on July 18, 2012, ABCD Holdings removed Hannon as an officer of Ware Real Estate and appointed McLaughlin to replace him. Hannon, however, continued to operate ABC&D Recycling until February 6, 2013, when ABCD Holdings removed him as an officer and director of that company as well. On March 13, 2013, the bankruptcy court approved the sale of Hannon's remaining minority interest in both Ware Real Estate and ABC&D Recycling to ABCD Holdings.

Hannon's Monthly Operating Reports

Hannon was required to file monthly operating reports ("MORs") on a standardized form with the United States Trustee's office. He did so from May through September of 2012. Hannon says that he provided his counsel with bank statements from the debtor-in-possession accounts and, based on those statements, counsel completed the necessary forms for him. Hannon then reviewed the forms and signed a certification on each MOR which declared

"under penalty of perjury" that the report was true and correct "to the best of [his] knowledge and belief."

The MOR forms require, among other things, that a debtor affirmatively disclose whether funds have been disbursed for the debtor's benefit from any account other than a debtor-in-possession account, and, if so, to provide an explanation for such payments. Here, that would include disclosure of disbursements made by ABC&D Recycling and Ware Real Estate for Hannon's benefit. The MOR form also instructs the debtor to report the amount of estate disbursements made by outside sources. On all of the relevant MORs, Hannon reported that funds had been disbursed for his and his wife's benefit from an account other than a debtor-in-possession account. In May and June of 2012, for example, Hannon's MORs identified $1,407.24 and $2,830.30, respectively, as "payments from ABC&D for rent and utilities." Hannon's September MOR also disclosed that funds had been disbursed from "ABC&D for rent and utilities," but reported that no ***67** amount ("0") had been disbursed for the estate's benefit from outside sources. Hannon's July and August MORs contained no reference to disclosable payments from ABC&D Recycling, and reported "0" estate disbursements made by outside sources.

Companies Object to Discharge

On July 12, 2013, ABCD Holdings, ABC&D Recycling, and Ware Real Estate (the "Companies") filed an adversary complaint against Hannon in the bankruptcy proceeding, objecting to his discharge in bankruptcy. Based upon a forensic accounting analysis of the books and records of ABC&D Recycling and Ware Real Estate, the Companies alleged that while Hannon was in control of the businesses, he diverted a substantial amount of business revenue to his own benefit, without authority. According to the Companies, business funds were diverted by means of: (1) Hannon's use of business accounts to pay Hannon's entirely personal expenses; (2) Hannon's withdrawal of funds from business bank accounts for entirely personal use; and (3) Hannon's and his family members' use of business debit cards to cover entirely personal expenses. The Companies asserted that Hannon did not disclose receipt of the majority of those diverted funds on his MORs, as required. They charged that Hannon diverted approximately $99,000 from ABC&D Recycling and Ware Real Estate between May and September of 2012, during which period he only identified approximately $4,200 in disbursements made on his behalf on the MOR forms.

On November 21, 2013, the Companies moved for partial summary judgment on their claim that, because Hannon made a false oath or filed a false account in connection with his bankruptcy proceeding, he should be denied a discharge. 11 U.S.C. § 727(a)(4)(A). Hannon, acting pro se,[2] opposed the motion but did not deny that the disbursements identified by the Companies actually occurred. Instead, he contended that virtually all of the identified expenditures were made for business purposes, and not for his personal benefit. And, he argued, some expenditures that appeared to be for his personal benefit were actually made by, or on behalf of, other employees.

Hannon's Proffered Defenses

A hearing was held in the bankruptcy court on the Companies' motion. The bankruptcy court questioned Hannon about the transactions at issue. Hannon denied that the identified disbursements were made for his personal benefit, stating that nearly all of them ("99.9 percent of them") had a business purpose. The bankruptcy court took the matter under advisement, but offered Hannon the opportunity to "spell out in detail" his defenses to the multiple diversion claims.

Hannon then retained new legal counsel, who filed a further brief in opposition to the Companies' motion for partial summary judgment. Hannon retreated from his earlier claim that 99.9 percent of the disbursements had a business purpose, but included an affidavit in which he declared that many of the disbursements and withdrawals from business accounts actually had a business purpose. He also filed an affidavit by Jeffrey M. Dennis, CPA, in which Dennis opined that laypersons (like Hannon, who had a high school education) typically lack the necessary training to ***68** accurately complete MORs. Finally, Hannon provided the court with an unsworn attachment to his memorandum, in the form of a spreadsheet, detailing his explanations for each of the disbursements challenged by the Companies. Hannon's explanations were divided into three categories: 1) those expenditures that Hannon "believe[d] were incurred for his benefit," 2) those that he "believe[d were] incurred for legitimate business purposes," and 3) those that he claimed were incurred for both a personal and a business purpose.

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Hannon conceded that $19,323.22 in business disbursements were “incurred for his benefit.” Those transactions included eleven cash withdrawals, which Hannon labeled as “Stipends to Joint Debtor” (his wife); two paychecks to Hannon from ABC&D Recycling; $7,500 in rent payments made to Hannon's landlord; $1,500 in payments to a boat storage facility in Maine; retail purchases for groceries, clothing, and entertainment; and video game and music purchases made by Hannon's daughters on a business debit card.[3]

Hannon identified $77,155.91 of the challenged disbursements as having a business purpose, including substantial cash withdrawals used to make cash payments for scrap metal, expenses related to business travel, and expenses associated with transporting and feeding

ABC&D Recycling employees.[4] He included within that category costs associated with two of his homes, one in Wells, Maine, and another in Truro, Massachusetts. According to Hannon, those vacation homes were used for entertaining potential ABC&D clients, so costs associated with maintaining those homes, as well as monies spent entertaining clients while in residence, qualified as business expenses. Disbursements were made to cover costs for utilities, landscaping, local hardware and liquor store purchases, and meals at nearby restaurants.

Finally, Hannon identified $2,849.99 of the questioned disbursements as having both a personal and a business purpose. He included within that final category utility payments related to his Wells and Truro homes.

Hannon had previously given testimony concerning his Wells and Truro homes at a June 6, 2012, meeting of creditors. In response to questioning by counsel to the United States Trustee, Hannon said that he and his family used the Wells home only occasionally and during the day, and that it needed significant work (as a result of major leaks and a dysfunctional heating system) to make it rentable. The Truro vacation home, he said, was used only “once in a while” and otherwise remained unoccupied. He did not mention any marketing or other business entertainment uses of either property.

B. Procedural History On June 10, 2014, after fully considering the matter, the bankruptcy judge granted summary judgment in favor of the Companies and declined to grant Hannon a discharge in bankruptcy. 11 U.S.C. § 727(a)(4)(A). The court found, as Hannon admitted, that over $19,000 in payments by ***69** ABC&D Recycling or Ware Real Estate were made for Hannon's personal benefit, and that the majority of those payments were not disclosed on the MORs, as required. The bankruptcy court found that Hannon's affidavit explanations for the claimed business expenditures related to his Wells and Truro homes were directly contradicted by his earlier testimony at the creditors' meeting, and that Hannon provided no explanation for the substantive change. Accordingly, the bankruptcy court determined that Hannon failed to raise a genuine issue of material fact with respect to whether the business payments relating to his Wells and Truro houses were “in fact incurred solely for his personal benefit.”

The bankruptcy court took note of the extent and frequency of Hannon's omissions, as well as the fact that Hannon had partially disclosed payments made for his benefit by ABC&D Recycling in his May and June MORs. From the undisputed facts, the bankruptcy court determined that the “only plausible conclusion is that [Hannon] acted with reckless indifference to the truth when filing his MORs.” The court decided that it was unnecessary to consider the additional disbursements at issue, because Hannon admitted sufficient unreported payments made on his behalf to resolve the motion for summary judgment.

Hannon appealed to the district court. The district court affirmed the bankruptcy court's order on September 22, 2015. This appeal followed.

II. Standard of Review

[1] **[2]**As recently noted in Rok Builders, LLC v. 2010–1 SFG Venture, LLC, (In re Moultonborough Hotel Group, LLC), “[a]lthough we constitute the second tier of appellate review in this case arising out of a decision by the bankruptcy court in an adversary proceeding, 'we cede no special deference to the determinations made by the ... district court' and instead 'assess the bankruptcy court's decision directly.'” 726 F.3d 1, 4 (1st Cir. 2013) (quoting City Sanitation, LLC v. Allied Waste Servs. of Mass., LLC (In re Am. Cartage, Inc.), 656 F.3d 82, 87 (1st Cir. 2011)). Our review of the bankruptcy court's order granting summary judgment is de novo. Desmond v. Varrasso (In re Varrasso) 37 F.3d 760, 763 (1st Cir.

1994) (citations omitted); see also Daniels v. Agin, 736 F.3d 70, 78 (1st Cir. 2013).

[3] [4] The bankruptcy court entered summary judgment under Federal Rule of Bankruptcy Procedure 7056, which expressly "incorporates into bankruptcy practice the standards of Rule 56 of the Federal Rules of Civil Procedure." In re Varrasso, 37 F.3d at 762. Accordingly, the "legal standards traditionally applicable to motions for summary judgment ... apply without change in bankruptcy proceedings." In re Moultonborough Hotel Grp., LLC, 726 F.3d at 4 (citations omitted). Summary judgment in bankruptcy proceedings, then, should be granted "only when no genuine issue of material fact exists and the movant has successfully demonstrated an entitlement to judgment as a matter of law." In re Varrasso, 37 F.3d at 763. "[A]ll reasonable inferences from the facts must be drawn in the manner most favorable to the nonmovant." Id.

III. Discussion

[5] [6] [7] [8] [9] [10] We begin with a basic jurisdiction." Bank of Marin v. England, 385 U.S. 99, 103 [87 S.Ct. 274, 17 L.Ed.2d 197] (1966). In that vein, the statutory right to a discharge should ordinarily be construed liberally in favor of the debtor. Matter of Vickers, 577 F.2d 683, 687 (10th Cir. 1978); In re Leichter, 197 F.2d 955, 959 (3d Cir. 1952), principle. "Under [11 U.S.C.] § 727(a)(4)(A), [a] debtor can be refused his discharge only if he (i) knowingly and fraudulently made a false oath, (ii) relating to a material fact." Boroff v. Tully (In re Tully), 818 F.2d 106, 110 (1st Cir. 1987). As the moving parties, the Companies must establish that there is no genuine dispute about any material fact, ***70** and that they are entitled to judgment as a matter of law, because: (1) Hannon made a false statement under oath in the course of his bankruptcy proceeding; (2) he did so knowingly and fraudulently; and (3) the false statement related to a material fact. Perry v. Warner (In re Warner), 247 B.R. 24, 26 (1st Cir. BAP 2000). As we have previously recognized:

> [11 U.S.C. § 727], by its very nature, invokes competing considerations. On the one hand, bankruptcy is an essentially equitable remedy. As the [Supreme] Court has said, it is an "overriding consideration that equitable principles govern the exercise of bankruptcy

A. False Oath

[11] The bankruptcy court, invoking the principle that "an unsworn declaration made under penalty of perjury is the

> cert. denied, 344 U.S. 914 [73 S.Ct. 336, 97 L.Ed. 705] (1953); Roberts v. W.P. Ford & Son, Inc., 169 F.2d 151, 152 (4th Cir. 1948). "The reasons for denying a discharge to a bankrupt must be real and substantial, not merely technical and conjectural." Dilworth v. Boothe, 69 F.2d 621, 624 (5th Cir. 1934).
>
> On the other hand, the very purpose of certain sections of the law, like 11 U.S.C. § 727(a)(4)(A), is to make certain that those who seek the shelter of the bankruptcy code do not play fast and loose with their assets or with the reality of their affairs. The statutes are designed to insure that complete, truthful, and reliable information is put forward at the outset of the proceedings, so that decisions can be made by the parties in interest based on fact rather than fiction. As we have stated, "[t]he successful functioning of the bankruptcy act hinges both

In re Tully, 818 F.2d at 110 (parallel citations omitted). With these principles in mind, we turn to Hannon's arguments on appeal.

> upon the bankrupt's veracity and his willingness to make a full disclosure." [Matter of] Mascolo, 505 F.2d [274,] 278 [(1st Cir. 1974)].

equivalent of a verification under oath," determined that, because Hannon signed the MORs under penalty of perjury, his statements on those forms were made under oath. 28 U.S.C. § 1746; Smith v. Grondin (In re Grondin), 232 B.R. 274, 276 (1st Cir. BAP 1999). Hannon challenges that determination on appeal, arguing that the certification required by MORs is not the type of certification covered by § 1746, which contemplates a certification as "true and correct," and not one based on a subjective understanding. Therefore, he argues, his MOR certifications were not made under "oath," as necessary to support a false oath claim.

Hannon concedes that he presents the argument for the first time on appeal. "[T]herefore, we can consider the argument waived." Hoover v. Harrington (In re Hoover), 828 F.3d 5, 11 (1st Cir. 2016) (quoting Net–Velazquez v. Wiscovitch–Rentas (In re Net–Velazquez), 625 F.3d 34, 40 (1st Cir. 2010)) ("[A]bsent the most extraordinary circumstances, legal theories not raised squarely in the lower court cannot be broached for the first time on appeal."). However, even if Hannon had presented the argument to the bankruptcy court, it would have likely failed. The verification language used on the

MOR is nearly identical to the verification language used on debtor bankruptcy schedules. ***71** [5] Other circuit courts that have addressed the point have consistently found the language used on the debtor schedules sufficient to constitute a verification under oath for purposes of § 727(a)(4)(A). See, e.g., Retz v. Samson (In re Retz), 606 F.3d 1189, 1196 (9th Cir. 2010) ("A false statement or an omission in the debtor's bankruptcy schedules or statement of financial affairs can constitute a false oath.") (quoting Khalil v. Developers Sur. & Indem. Co. (In re Khalil), 379 B.R. 163, 172 (9th Cir. BAP 2007)); Beaubouef v. Beaubouef (Matter of Beaubouef), 966 F.2d 174, 178 (5th Cir. 1992) ("False oaths sufficient to justify the denial of discharge include ... a false statement or omission in the debtor's schedules") (internal quotations omitted) (quoting 4 Collier on Bankruptcy ¶ 727.01[1], at 727–59 (15th ed. 1992)); Chalik v. Moorefield (In re Chalik), 748 F.2d 616, 618 n.3 (11th Cir. 1984) ("A knowing and fraudulent omission from a sworn Statement of Affairs or schedule may constitute a false oath.") (citing Farmers Coop. Ass'n v. Strunk, 671 F.2d 391, 395 (10th Cir. 1982)).[6]

We do not discern any principled basis upon which to draw a meaningful distinction between the certification language used on the MOR form from that used on a debtor's schedules, and think the nearly identical language used on the MOR form would likely constitute a verification under oath for § 727(a)(4)(A) purposes. "Sworn statements filed in any court must be regarded as serious business. In bankruptcy administration, the system will collapse if debtors are not forthcoming." In re Tully, 818 F.2d at 112. So, while it is unlikely that Hannon would prevail, the issue is forfeited in this case due to Hannon's failure to raise it below.

B. "Knowingly and Fraudulently"

[12] Hannon's main argument on appeal relates to the bankruptcy court's determination that there was no genuine issue of material fact with respect to his state of mind when he filed the MORs. Hannon asserts that the bankruptcy court incorrectly concluded that the undisputed facts established his knowing and fraudulent state of mind as a matter of law. Relying upon our decision in In re Varrasso, 37 F.3d at 764, he argues that the undisputed facts here—as in In re Varrasso—do not point to only one conclusion about his state of mind, but instead support "conflicting yet plausible inferences—inferences that are capable of leading a rational factfinder to different outcomes in a litigated matter depending on which of them the factfinder draws." Id. Because the undisputed facts require a choice between two plausible, and conflicting, inferences (reckless conduct or merely careless conduct), he argues, summary judgment was improper.

Hannon says the undisputed facts support an inference that he acted carelessly, but not recklessly. He stresses that he had no reason to conceal the business disbursements made for his personal benefit because, even including those disbursements, ***72** his actual monthly expenses were still significantly lower than the monthly support amount he estimated would be needed at the outset of the bankruptcy proceeding. So, no harm, and no intent, given no evident reason for him to conceal those disbursements. He also notes that his formal education ended with high school, and he could well have misinterpreted the complicated bankruptcy forms. Moreover, he points out that he relied on legal counsel to prepare the forms. Those facts should render a culpable mental state doubtful, he contends.

Hannon also points to his "good faith" participation in the bankruptcy process, and his improved reporting practices over time, which also should tend to negate any inference of an intent to deceive. Finally, Hannon argues that accurate MOR reporting was necessarily hampered by his lack of access to underlying financial documentation about the businesses. Files and records were missing, he says, after the brief hiatus between the issuance of the temporary restraining order and his resumption of control over ABC&D's operations when the restraining order was modified. All of which, Hannon argues, would readily support a legal conclusion that he acted carelessly, but did not act with reckless indifference to the truth.

[13] **[14]** A debtor "knowingly and fraudulently" makes a false oath if he "knows the truth and nonetheless willfully and intentionally swears to what is false." Lussier v. Sullivan (In re Sullivan), 455 B.R. 829, 837 (1st Cir. BAP 2011) (internal quotation marks and citations omitted). "[R]eckless indifference to the truth" has "consistently been treated as the functional equivalent of fraud for purposes of § 727(a)(4)(A)." In re Tully, 818 F.2d at 112 (citations omitted); accord In re Grondin, 232 B.R. at 277.

[15] [16] We of course recognize that it has been repeatedly emphasized, and remains true today, that "[c]ourts use special caution in granting summary judgment as to intent. Intent is often proved by inference, after all, and on a motion for summary judgment, all reasonable inferences must be drawn in favor of the nonmoving party." Daniels, 736 F.3d at 83. But, "[s]ummary judgment may be warranted even as to such elusive elements as a defendant's motive or intent where the non-moving party rests merely upon conclusory allegations, improbable inferences, and unsupported speculation." Santiago v. Canon U.S.A., Inc., 138 F.3d 1, 5 (1st Cir. 1998) (quotations and citations omitted). Here, there are no genuine disputes regarding material facts, and construing the undisputed facts and all reasonable inferences arising from those facts in favor of Hannon, it is still clear that the entry of summary judgment was proper.

First, Hannon's reliance on In re Varrasso, 37 F.3d 760, is misplaced, because the undisputed facts here do not support plausible opposing inferences. Hannon concedes that he did not report at least $8,500 in business payments made for his personal benefit on the MORs he filed in May through September of 2012.[7] His explanation ***73** for those omissions amounted to little more than assertions that, either he did not understand his obligation to truthfully report those disbursements, or he failed to accurately report them because he was merely careless. Neither explanation is supported by the factual record.

[17] To be sure, "a debtor's honest confusion or lack of understanding may weigh against an inference of fraudulent intent." Robin Singh Educ. Servs., Inc. v. McCarthy (In re McCarthy), 488 B.R. 814, 827 (1st Cir. BAP 2013). But, Hannon did properly report some business disbursements made for his personal benefit in May and June of 2012. As the bankruptcy court recognized, those May and June disclosures "demonstrate[ ] that [Hannon] understood his duty to report such transactions, and was able to obtain the necessary information to do so." As the bankruptcy court also recognized, the "magnitude of the omissions belies the Debtor's assertions that he merely overlooked" reporting a few small personal transactions. In this case Hannon reported a few modest personal transactions; it was the multiple and substantial disbursements made for his benefit that did not make it to the MORs. Moreover, unlike the debtors in Varrasso, Hannon did not rectify the omissions as soon as the creditors' questioning brought them to light. In re Varrasso, 37 F.3d at 764.

At issue here is not a simple failure to report minor expenditures for miscellaneous expenses. Rather, Hannon repeatedly failed to report thousands of dollars diverted from the businesses for his benefit, while he controlled those businesses. He cannot plausibly contend that he did not know that the businesses paid for his personal rent, clothing, and groceries, as well as his daughters' clothing and entertainment, over a five-month period. Considered in context, "[t]he amounts here render reckless errors that arguably may have been only negligent if they had concerned less significant items." Daniels, 736 F.3d at 85.

[18] Hannon's claim that he relied in good faith on legal counsel to accurately prepare the forms also founders. As Hannon himself concedes, "reliance on the advice of counsel is no defense when the deficiency 'should have been evident to the debtor.' " Appellant's Br. at 20 (quoting Tully, 818 F.2d at 111). Hannon's argument is undermined both by his demonstrated knowledge of what was required to be disclosed, and his undeniable knowledge that substantial sums spent on his behalf were not disclosed on the forms filled out ***74** by counsel— forms that he reviewed and signed under oath.

[19] Hannon also asserts that a reasonable factfinder could well conclude that he lacked the financial acumen to understand and appreciate the MORs deficiencies. But, as discussed above, in May and June of 2012 Hannon did properly report disbursements made for his benefit. He plainly demonstrated personal awareness of what disclosures were required, and clearly was not unaware that business disbursements made for his benefit had to be reported. It, therefore, "should have been evident" to Hannon that the July, August, and September MORs did not disclose substantial business expenditures made for his benefit. Appellant's Br. at 20 (quoting In re Tully, 818 F.2d at 111). As we have warned, "[a] debtor cannot, merely by playing ostrich and burying his head deeply enough in the sand, disclaim all responsibility for statements which he has made under oath." In re Tully, 818 F.2d at 111.[8] While Hannon has no formal training in financial reporting, still, he is hardly unsophisticated. Until recently, he owned and successfully operated two businesses. He entered bankruptcy having accumulated assets of nearly $6 million. Moreover, this is not

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Hannon's first experience with bankruptcy filings and reports. Hannon acknowledges that he was "previously the principal of Embassy Realty, LLC, which had operated as a debtor-in-possession." Hannon's business experience and his past experience with the bankruptcy process undermine his claimed inability to accurately and truthfully complete the MORs due to a lack of financial sophistication.

Finally, Hannon's passing contention that his ability to accurately and truthfully disclose all business expenditures made for his benefit was hampered by missing financial documentation is also implausible. Hannon did not provide any explanation as to how access to the allegedly missing business records was a necessary predicate to his truthfully reporting substantial disbursements made on his behalf. Hannon, of course, did have access to all the financial records of ABC&D Recycling and Ware Real Estate through at least the end of June, 2012, yet still did not accurately and truthfully report disbursements made for his benefit on the May and June MORs. "The record in this case shows, at the very least, cavalier indifference and a pattern of disdain for the truth. Meaningful disclosure was accorded much too low a priority." In re Tully, 818 F.2d at 112.

Reviewing the matter de novo, we recognize this case as one of those uncommon situations in which summary judgment is appropriate notwithstanding that intent, or state of mind, is at issue. We concur in the bankruptcy court's determination that Hannon's proffered explanations for his significant omissions are so implausible that they do not give rise to a genuine dispute of material fact with respect to his intent.[9]

C. Materiality

[20] The final critical element, that the debtor's statement be materially related to ***75** the bankruptcy case, is "satisfied if the statement bears a relationship to the debtor's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of property." In re Sullivan, 455 B.R. at 829 (quotations omitted).

[21] Neither party disputes on appeal that Hannon's omissions were material. We agree. As the bankruptcy court noted, because Hannon's omissions "prevented parties in interest from accurately assessing the viability of a reorganization or understanding the Debtor's true financial condition," they were material.

IV. Conclusion

Summary judgment is not commonly available in cases featuring intent as a necessary element, but, as this case illustrates, there are exceptions. Material statements made in the course of judicial proceedings implicate serious interests, and must be as complete and reliable as studied caution will allow. Reckless indifference cannot be countenanced and will provide no protection from sanctions imposed for making false statements under oath.

For the reasons stated above, we affirm the bankruptcy court's denial of Hannon's discharge pursuant to § 723(a)(4)(A).

All Citations

839 F.3d 63, 63 Bankr.Ct.Dec. 64

Footnotes

* Of the District of New Hampshire, sitting by designation.

1 On January 2, 2013, the case was converted to a Chapter 7 proceeding, upon motion of the United States Trustee. 2 Hannon initially had the benefit of retained counsel to assist him in navigating the bankruptcy process, but was unable to maintain that representation. The bankruptcy court allowed counsel to withdraw by order dated July 13, 2013, after which Hannon acted pro se. He then retained new counsel after a hearing on the Companies' motion for partial summary judgment.

3 Hannon stated that he "believe[d]" the stipends to the Joint Debtor and his paychecks were reported on the MORs. 4 The bankruptcy court pointed out that Hannon included within the "business expense" category three disbursements he had previously listed on his Addendum to the May and June MORs as paid by ABC&D Recycling: a $97.84 payment to Dish Network, a $355.76 payment to NSTAR Electric, and a $178.89 payment to a Hannaford grocery store. Hannon cryptically described those payments as business expenses relating to "client guest house," "company utility," and "ABC&D grocery," respectively.

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5 The MOR certification reads: "I declare under penalty of perjury (28 U.S.C. Section 1746) that this report and all attachments are true and correct to the best of my knowledge and belief."

The "Declaration Concerning Debtor's Schedules" reads: "I declare under penalty of perjury that I have read the foregoing summary and schedules, consisting of ___ sheets, and that they are true and correct to the best of my knowledge, information and belief."

6 While the point seems not to have been directly confronted by this court, it has been assumed, for purposes of § 727(a)(4)(A), that omissions and false statements on a debtor's schedules constitute statements made under oath. See, e.g., In re Tully, 818 F.2d at 110.

7 Hannon takes issue with the bankruptcy court's categorization of some of the questioned expenditures as personal and unreported on the MORs. He argues that the bankruptcy court calculated the undisputed and unreported personal expenditures as totaling $23,555.54, but $10,092.98 of that amount was factually disputed. Actually, the bankruptcy court recognized that Hannon reported $4,237.54 of ABC&D Recycling's payments on his MORs, so the amount unreported on the MORs was "over $19,000." Hannon says he believed that $4,037 in cash stipends to Elizabeth Hannon were reported on the MORs, because they were included in deposits to Elizabeth Hannon's bank account, and so were recorded in bank statements attached to the MORs. The MORs, however, do not identify any such deposits as "stipends" or income from the business.

Hannon further argues that the expenditures of $3,205.09 and $2,849.99 relating to his Wells and Truro homes were "business" or "business and personal" expenses. That argument is equally unavailing. Hannon's affidavit is plainly inconsistent with his prior testimony at the creditors' meeting, and he offers no adequate explanation for the dramatic change. See Colantuoni v. Alfred Calcagni & Sons, Inc., 44 F.3d 1, 4–5 (1st Cir. 1994) ("When an interested witness has given clear answers to unambiguous questions, he cannot create a conflict and resist summary judgment with an affidavit that is clearly contradictory, but does not give a satisfactory explanation of why the testimony is changed."). But, even if we accepted Hannon's contentions, he cannot escape the fact that he admitted to receiving at least $12,830.97 from ABC&D Recycling and Ware Real Estate between May and September of 2012. He reported only $4,237.54 on his MORs. Hannon cannot, and does not, dispute that he failed to report over $8,500 in reportable payments that ABC&D Recycling and Ware Real Estate made for his personal benefit on the MORs he submitted between May and September 2012.

8 As the bankruptcy court pointed out, Hannon testified that he "provid[ed] counsel with statements from [his] debtor-inpossession accounts, and then reviewed the report prepared by counsel." But no evidence suggests that he provided counsel with full access to relevant financial information, including information regarding payments made by the businesses on his behalf.

9 On these same grounds, we reject Hannon's argument that the bankruptcy court should not have granted summary judgment because the MORs were verified "to the best of his knowledge and belief," and the record would support a finding that he subjectively believed that the information was accurate. As discussed above, the record does not support that inference.

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558 B.R. 473
United States Bankruptcy
Appellate Panel of the First Circuit.

Montreal, Maine & Atlantic Railway, Ltd., Debtor.
Robert J. Keach, Chapter 11 Trustee, Appellant,
v.
New Brunswick Southern Railway
Company Limited and Maine Northern Railway
Company, Appellees.

BAP NO. EB 16-015
|
Bankruptcy Case No. 13-10670-PGC
|
Filed October 21, 2016

Synopsis

Background: Trustee of Chapter 11 estate of debtorrailroad objected to priority "six months" claims filed by other railroads with which debtor had agreed to interchange freight traffic. The United States Bankruptcy Court for the District of Maine, Peter G. Cary, J., found that claims were in nature of priority "six months" claims, but declined to decide whether claims were allowable or in what amount. Trustee appealed.

Holdings: The Bankruptcy Appellate Panel, Feeney, Chief Judge, held that:

[1] interline freight claims asserted by other railroads withwhich Chapter 11 debtor-railroad interchanged freight traffic were not per se ineligible for priority as "six months" claims;

[2] bankruptcy court did not clearly err in finding thatclaims were for transportation services that these other railroads had provided to debtor, thereby satisfying necessary requirement for allowance on priority basis as "six months" claims;

[3] court did not clearly err in finding that claims werefor operating expenses "necessarily" incurred by debtor in connection with its rail operations;

[4] court did not clearly err in finding that other railroadshad not relied on debtor's general creditworthiness to obtain payment for transportation services that they provided.

Affirmed.

West Headnotes (16)

[1] Bankruptcy

Finality

Bankruptcy court decision is considered "final," and thus appealable as of right, if it ends litigation on the merits and leaves nothing for court to do but execute judgment. 28 U.S.C.A. § 158(a)(1).

Cases that cite this headnote

[2] Bankruptcy

Interlocutory orders; c ollateral order doctrine

"Interlocutory order" only decides some intervening matter pertaining to the cause, and requires that further steps be taken in order to enable court to adjudicate the cause on the merits. 28 U.S.C.A. § 158(a)(3).

Cases that cite this headnote

[3] Bankruptcy

Interlocutory orders; c ollateral order doctrine

Bankruptcy

Petition for leave; a ppeal as of right; c ertification

Bankruptcy court order determining that claims asserted in railroad reorganization case were entitled to priority, but not determining whether such claims should be allowed or in what amount, was "interlocutory order," that was not appealable as of right, but only with permission of bankruptcy appellate court. 28 U.S.C.A. § 158(a)(1, 3).

Cases that cite this headnote

[4] Bankruptcy

Conclusions of law; d e novo review

Bankruptcy

Clear error

Bankruptcy Appellate Panel (BAP) reviews bankruptcy court's findings of fact for clear error and its conclusions of law de novo. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[5] Bankruptcy

Conclusions of law; d e novo review

Bankruptcy

Clear error

Whether interline freight claims asserted by other railroads with which Chapter 11 debtor-railroad interchanged freight traffic could qualify for priority status as “six months” claims under provision of Chapter 11 applicable to railroad reorganizations was legal question, which Bankruptcy Appellate Panel would review de novo; however, bankruptcy court's subsidiary findings on elements of priority test were factual findings reviewable for clear error. 11 U.S.C.A. § 1171(b).

Cases that cite this headnote

[6] Bankruptcy

Presumptions and burden of proof

In order to rebut prima facie force of proof of claim that is executed and filed in accordance with Bankruptcy Rules, objecting party must produce substantial evidence in opposition thereto, whereupon the burden shifts to claimant to establish validity of its claim by preponderance of the evidence. Fed. R. Bankr. P. 3001(f).

Cases that cite this headnote

[7] Bankruptcy

Railroad Reorganization

In order for claim to be entitled to priority in railroad reorganization case as being in nature of “six months” claim, it must satisfy the three-pronged *Boston & Maine* test by (1) being for a current operating expense necessarily incurred by debtor-railroad, (2) within six months before its reorganization petition was filed, and (3) for goods or services that were delivered in the expectation that they would be paid for out of current operating revenues of debtor-railroad, and not in reliance on debtor-railroad's general credit. 11 U.S.C.A. § 1171(b).

Cases that cite this headnote

[8] Bankruptcy

Railroad Reorganization

Interline freight claims asserted by other railroads with which Chapter 11 debtorrailroad interchanged freight traffic were not per se ineligible for priority as “six months” claims, but could be allowed on priority basis if they satisfied the three elements of *Boston & Maine* test for priority. 11 U.S.C.A. § 1171(b).

Cases that cite this headnote

[9] Statutes

Language

Courts must presume that legislature says in statute what it means and means in statute what it says there.

Cases that cite this headnote

[10] Statutes

Plain, literal, or clear meaning; a mbiguity

If statutory language is unambiguous, court need not resort to legislative history to construe the plain text of statute.

Cases that cite this headnote

[11] Statutes

Purpose and intent; d etermination thereof

When statutory language is ambiguous, courts may look to statute's historical context, its legislative history, and the underlying policies that animate its provisions in order to determine legislative intent.

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Cases that cite this headnote

[12] Bankruptcy

Bankruptcy court did not clearly err, in Chapter 11 case of debtor-railroad, in finding that interline freight claims asserted by other railroads with which Chapter 11 debtor-railroad interchanged freight traffic were for transportation services that these other railroads had provided to debtor, thereby satisfying necessary requirement for allowance on priority basis as "six months" claims, given evidence that these claims arose from uncoupling of debtor's cars and recoupling them to locomotives owned by these other railroads, so that other railroads could transport goods that were on debtor's cars to their final destination; charges were for more than mere use of track belonging to these other railroads. 11 U.S.C.A. § 1171(b).

Cases that cite this headnote

[13] Bankruptcy

To qualify for priority in railroad reorganization as "six months" claim, claim must be for current operating expenses necessarily incurred by debtor-railroad in connection with its rail operations. 11 U.S.C.A. § 1171(b).

Cases that cite this headnote

[14] Bankruptcy

Bankruptcy court did not clearly err, in Chapter 11 case of debtor-railroad, in finding that interline freight claims filed by other railroads with which debtor interchanged freight traffic were for operating expenses "necessarily" incurred by debtor in connection with its rail operations, thereby satisfying necessary requirement for allowance on priority basis as "six months" claims, despite trustee's contention that, if other railroads had refused to interchange freight and denied debtor the use of their tracks, debtor could have utilized other routes to transport oil to place where it was being processed; in fact, interchange of oil shipments for transportation on these other railroads' tracks was only economical way for getting oil to processing site, without which debtor could not have competed for this business and would have experienced substantial reduction in its revenue. 11 U.S.C.A. § 1171(b).

Cases that cite this headnote

[15] Bankruptcy

In deciding whether claim is for operating expenses "necessarily" incurred by debtorrailroad in connection with its rail operations, as required for claim to be allowable on priority basis in railroad reorganization as being in nature of "six months" claim, court should not employ an "end of the world" or "doomsday" standard of necessity. 11 U.S.C.A. § 1171(b).

Cases that cite this headnote

[16] Bankruptcy

Bankruptcy court did not clearly err when it found, as prerequisite to allowance as priority "six months" claims of the interline freight claims filed against debtor-railroad by railroads with which it interchanged freight traffic, that these other railroads had not relied on debtor's general creditworthiness to obtain payment for transportation services that they provided by decoupling cars from debtor's locomotives and recoupling them to their own locomotives for transport to final point of delivery; evidence was presented that these other railroads, leery of fact that debtor had acquired its assets in bankruptcy case of another railroad and of troubled history of its line, had structured their relationship with debtor so that they would obtain payment by setoff against obligations owed by related company or by debtor's collection and immediate remittal of payments

that it received under interline settlement system. 11 U.S.C.A. § 1171(b).

Cases that cite this headnote

***476 Appeal from the United States Bankruptcy Court for the District of Maine, (Hon. Peter G. Cary, U.S. Bankruptcy Judge)**

Attorneys and Law Firms

Robert J. Keach, Esq., and Lindsay K. Zahradka, Esq., on brief for Appellant.

Alan R. Lepene, Esq., and Keith J. Cunningham, Esq., on brief for Appellees.

Before Feeney, Deasy, and Harwood, United States Bankruptcy Appellate Panel Judges.

Opinion

Feeney, Chief U.S. Bankruptcy Appellate Panel Judge.

Robert J. Keach, the former chapter 11 trustee (the "Appellant"),[1] appeals the bankruptcy court's February 26, 2016 order (the "Order") overruling in part his objections to certain proofs of claim filed by New Brunswick Southern Railway Company Limited ("NBSR") and Maine Northern Railway Company ("MNR" and, collectively with NBSR, the "Irving Railroads"). The Appellant appeals the bankruptcy court's ruling that the Irving Railroads' claims qualified as so-called "six months claims" entitled to priority under § 1171(b).[2] For the reasons set forth below, we **AFFIRM**.

BACKGROUND

I. Pre-Bankruptcy Events

From January 2003 until May 2014, Montreal, Maine & Atlantic Railway, Ltd. ("MMA") owned and operated an integrated, international shortline freight railroad system with its wholly owned Canadian subsidiary, Montreal, Maine & Atlantic Canada Co.[3] This railroad system included ***477** 510 route miles of track in Maine, Vermont, and Québec, and was a substantial component of the rail transportation systems in northern Maine, northern New England, Québec, and New Brunswick. Among other things, it provided the shortest rail transportation route between Maine and Montréal, and was a "critical rail artery" between St. John, New Brunswick and Montréal. In order to provide freight transportation services to customers throughout the system, MMA interchanged freight traffic with other railroads, including the Irving Railroads, with which its operations were interconnected.

A. The Interline Settlement System

MMA, like most railroads, participated in the Interline Settlement System (the "ISS"). The ISS provides a central clearing house for all participating railroads involved in the interchange of freight traffic among multiple rail carriers to settle accounts receivable and accounts payable arising from the interchange of such traffic. Railroads participating in the ISS that originate traffic are known as "billing" or "originating" railroads and invoice the customer for all freight charges from the point of origin to the point of destination, even if the shipment is interchanged with other railroads along the route. The customer is responsible for paying the billing railroad the entire invoice, and the billing railroad is responsible for paying the other railroads involved in the shipment along the line for their share of the freight charges. Railroads participating in the ISS calculate on a monthly basis the accounts receivable and accounts payable arising from the interchange of traffic that are due and owing to each participant, and the payment of the net amount due and owing is made on the second business day of each month. One of the benefits of participating in the ISS is that billing railroads are obligated to pay the other participating railroads regardless of whether the customer pays the billing railroad.

B. The Relationship between MMA and the Irving Railroads

The business relationship between MMA and the Irving Railroads began in January 2003, when MMA entered into a Commercial Agreement (the "Commercial Agreement") with NBSR and one of NBSR's affiliates, Eastern Maine Railway Company ("EMR"),[4] setting forth various terms and conditions governing the interchange of freight traffic between MMA and the Irving Railroads. Pursuant to the Commercial Agreement and a separate Interchange Agreement between MMA and EMR, the Irving Railroads and MMA agreed to interchange freight traffic at MMA's

Brownville Junction Yard in Maine. Section 2 of the Commercial Agreement, entitled "Performance of Transportation Services," provided as follows:

> The parties agree that from and after the Effective Date, EMR/NBS[R] shall move loaded freight cars and associated empty cars between points located on its lines or reached by it under Canadian interswitch rules and Brownville Junction at rates as set out in this Agreement. MMA shall act as the interline tariff carrier on a junction settlement basis. By "junction settlement basis" the parties mean that MMA shall negotiate through rates and make contracts and provide quotations, and shall be responsible for car supply to the extent requested ***478** by NBS[R] and reasonably available from MMA and in rail cars customarily supplied by railroad carries, all in accordance with the provisions of this Agreement. MMA shall continue to render one freight bill, and assess and collect the total amount of freight charges ... and remit the portion pertaining to EMR/ NBS[R's] transportation services to EMR/NBS[R] in accordance with the procedures in this Agreement.

At the evidentiary hearing described below, and while addressing the freight carried by MMA to the interchange point with the Irving Railroads, Ian Simpson, general manager of the Irving Railroads, explained that the interchange of freight traffic involved the decoupling of freight cars from MMA's locomotives and connecting them to the Irving Railroads' locomotives, which then carried the freight cars to their final destination.

The Irving Railroads did not participate in the ISS.[5]
As a result, pursuant to the Commercial Agreement, MMA acted as the billing railroad when either of the Irving Railroads originated traffic and interchanged with MMA, as well as when MMA originated traffic and interchanged with either of the Irving Railroads. MMA also collected from the ISS freight revenue attributable to freight services provided by the Irving Railroads in connection with shipments originated by other carriers that were interchanged by such carriers with MMA and then by MMA with the Irving Railroads. Periodically, MMA and the Irving Railroads settled their accounts payable and receivable as between themselves. Other than certain amounts for repair of cars owned or leased by MMA, the Irving Railroads' claims, as described below, arose from MMA's collection of funds either from customers or through the ISS and its failure to pay amounts due to the Irving Railroads.

C. The "Payment Swap" Arrangement At the time MMA and the Irving Railroads began doing business, Karl Hansen, general manager of Corporate Credit and Finance for the Irving Railroads and their affiliated companies, had concerns MMA would not be able to pay the Irving Railroads due to the troubled history of MMA's predecessor, Bangor & Aroostook. As a result, the Irving Railroads, together with certain of their affiliated paper companies, Irving Pulp and Paper, Limited, Irving Paper Limited, and J.D. Irving, Limited (collectively, the "Irving Paper Companies"), which were among MMA's largest customers, agreed with MMA on a process to settle their respective accounts receivable and accounts payable by concurrently exchanging payments through wire transfers of amounts owed to each other. Included in this "payment swap" arrangement[6] were: (1) accounts payable owed by ***479** the Irving Paper Companies to MMA for freight services provided by MMA to the Irving Paper Companies; (2) accounts payable owed to MMA by the Irving Railroads for interline freight services provided by MMA; and (3) accounts receivable owed by MMA to the Irving Railroads for interline freight services provided by them. Under this arrangement, the parties would determine, based upon the payment terms in effect between them, the amounts due from the Irving Railroads and the Irving Paper Companies to MMA, and the amounts due from MMA to the Irving Railroads, and then concurrently exchange cash payments in the agreed upon amounts. Initially, the amounts owed to MMA by the Irving Railroads and the Irving Paper Companies each week greatly exceeded the amounts owed by MMA to the Irving Railroads. Mr. Hansen explained the reason for entering into this arrangement as follows: "I was determined that I was not going to take a credit risk, I was not relying on their credit to [e]nsure we got paid."

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D. The Agreement Regarding Oil Shipments The payment swap arrangement worked well until the volume of crude oil shipments carried by MMA and interchanged with the Irving Railroads for delivery to refineries in St. John, **New Brunswick** began to increase significantly in 2012. In the two years leading up to the bankruptcy filing, MMA benefited from the increased use of trains to move oil from the central and western regions of the United States to refineries in the east. United States and Canadian oil drillers were producing oil faster than the **new** pipelines could be built, and trains were needed to transport crude oil to refineries. During this time, MMA was hauling 500,000 barrels of oil monthly through Québec and Maine. For the majority of such oil shipments, the originating railroad was Canadian Pacific Railway Company and its affiliates ("CP"), which participated in the ISS. CP was the first railroad to haul the oil, and the shipment would then travel across the country over a number of railway lines until it eventually interchanged with MMA. MMA would haul the oil over its lines and then interchange the freight with the Irving Railroads, which delivered the oil to its final destination at the Irving Oil refinery in St. John, **New Brunswick**.[7]

The payments for the oil shipments were processed through the ISS. Because the Irving Railroads were not members of the ISS, they could not collect from the ISS for their share of freight interline charges. Rather, the ISS paid MMA, and MMA paid the Irving Railroads pursuant to the terms of their payment arrangement.

Typically, MMA did not receive payments through the ISS until 45 to 60 days following the shipments. Under the terms of payment in effect with the Irving Railroads, however, MMA was obligated to pay the Irving Railroads its share of the freight charges for oil shipments within 33 days of shipment. This was not a problem when the Irving Paper Companies owed MMA more than MMA owed them. But eventually, due to the significant increase in oil shipments carried by MMA and interchanged with the Irving Railroads for delivery to St. John, **New Brunswick**, the amounts owed by MMA for interline ***480** freight services provided by the Irving Railroads began to exceed the amounts owed by the Irving Paper Companies to MMA, and MMA did not have enough cash to make the simultaneous payments under the swap arrangement.

In order to address this situation, in July 2012, the parties agreed MMA would pay the Irving Railroads for their share of freight charges earned in connection with oil shipments promptly upon MMA's receipt of payment from the ISS, and in no event later than five days thereafter. According to the Irving Railroads, the amounts owed to them for interline freight charges incurred in connection with oil shipments were "carved out of the swap arrangement, and instead, those charges would be paid to the Irving Railroads upon MMA's receipt of payment from the ISS of the amounts owed to MMA for such shipments." As to "local" shipments (those which were originated either by MMA and interchanged with the Irving Railroads, or those originated by the Irving Railroads and interchanged with MMA), the swap arrangement remained in effect.

II. The Derailment and MMA's Bankruptcy Filing

On July 6, 2013, an unmanned train operated by MMA containing 72 tank cars filled with crude oil derailed in Lac-Mégantic, Québec, causing several large explosions, the death of 47 people, and significant property and environmental damage. After the derailment, train activity was temporarily halted between Maine and Québec, resulting in the immediate loss of most of MMA's freight business and a drastic fall in MMA's gross revenues.

On August 7, 2013, MMA filed a chapter 11 petition in the U.S. Bankruptcy Court for the District of Maine, and the Appellant was subsequently appointed as the chapter 11 trustee. On January 24, 2014, the bankruptcy court entered an order approving the sale of substantially all of MMA's assets as a going concern to Railroad Acquisition Holdings LLC. The sale of MMA's assets closed on May 15, 2014.

On June 13, 2014, MNR and NBSR timely filed proofs of claim (collectively, the "Claims").[8] In Claim 259-1, NBSR asserted claims in the aggregate amount of $2,164,471.30 arising from "[f]reight services provided to [MMA] in connection with interline rail shipments." Of the total amount claimed, NBSR asserted not less than $1,971,834.67 was "secured by equitable liens against all property of [MMA] under the Six Month[s] Rule applicable in federal court receiverships, and [we]re entitled to priority pursuant to 11 U.S.C. § 1171(b)," because such claims: (1) related to current operating expenses incurred by MMA that were necessary for the on-going operation of MMA's railroad; (2) were incurred within six months prior to the commencement of MMA's bankruptcy case; and (3) were

for services provided by NBSR with the expectation they would be paid out of current operating revenue and not in reliance on MMA's general credit.

In Claim 257-1, MNR asserted claims in the aggregate amount of $355,101.19 arising from "[f]reight services provided to [MMA] in connection with interline rail shipments." Of the total amount claimed, MNR asserted approximately $167,228.89 was entitled to priority under § 1171(b) for ***481** the same reasons advanced by NBSR in Claim 259-1.

On July 16, 2015, the Appellant filed the Plan and Revised First Amended Disclosure Statement ("Disclosure Statement").[9] The Irving Railroads objected to confirmation of the Plan arguing, among other things, that it failed to provide the same treatment for allowed § 1171(b) claims as it provided for administrative expense claims—i.e., payment in full following confirmation of the Plan.

On October 9, 2015, the bankruptcy court entered an order confirming the Plan ("Confirmation Order"). The Confirmation Order provided, in relevant part:

> In resolution of the [Irving Railroads'] Objection, any 1171(b) Claims of the [Irving Railroads] shall be paid in full, in Cash, on the later of the Initial Distribution date or thirty (30) days after the date such Claims become Allowed Claims. In the event the Bankruptcy Court has not determined, prior to the Initial Distribution Date, the existence of and/or the amount of any Allowed 1171(b) Claims of the [Irving Railroads], if any, as of such date, the Trustee shall set aside, and not distribute pending further order of the Bankruptcy Court making such determination, $2,139,063.56 to secure any payment, to the extent required, with respect to such Allowed 1171(b) Claims, when and if determined.

On October 19, 2015, the Appellant filed an objection to the Claims (the "Claims Objection"), on the ground they were improperly asserted as priority claims and should be allowed only as general unsecured claims. Specifically, the Appellant argued, "as a matter of controlling law in this circuit," pre-petition interline freight claims of the type asserted by the Irving Railroads are general unsecured claims and do not qualify as six months claims entitled to priority under § 1171(b), citing In re Boston & Maine Corp., 600 F.2d 307 (1st Cir. 1979) ("Boston & Maine I"). The Appellant also argued, in furnishing services to MMA, the Irving Railroads relied—not on MMA's operating revenues at the time the service was provided —but upon MMA's general credit and, as a consequence, their claims were not entitled to priority as § 1171(b) claims, citing In re Boston & Maine Corp., 634 F.2d 1359 (1st Cir. 1980) ("Boston & Maine II").

In their response ("Irving Railroads' Response"), the Irving Railroads argued Boston & Maine I was not applicable or controlling law on the issue because the court did not decide, or even address, the issue of whether interline freight claims qualify as six months claims entitled to priority in a railroad reorganization; rather, Boston & Maine I only addressed the question of the timing of the payment of such claims. The Irving Railroads also contended the question of whether the interline freight claims asserted in Boston & Maine I were entitled to treatment as priority claims under the plan of reorganization was addressed by the U.S. Court of Appeals for the First Circuit in the subsequent case of Boston & Maine II. According to the Irving Railroads, in Boston & Maine II, the First Circuit reversed a decision of the district court ruling those claims should be treated as general unsecured claims, holding instead that per diem claims, such as those asserted by the interlining railroads, constituted six months claims entitled to priority, if such claims: (1) represented a current operating expense necessarily incurred; ***482** (2) were incurred within six months before the reorganization petition was filed; and (3) the goods or services were delivered in the expectation that they would be paid for out of current operating revenues of the railroad, and not in reliance on the railroad's general credit. And, the Irving Railroads maintained, the evidence clearly established the Claims satisfied the test articulated in Boston & Maine II.

On November 19, 2015, the parties filed stipulations with respect to the Claims Objection, in which they stipulated to certain facts and agreed the only issue to be addressed at the hearing on the Claims Objection was whether the Claims qualified as six months claims entitled to priority under §

1171(b); the amount of such Claims would be determined at a subsequent hearing, if required.

On November 20, 2015, the bankruptcy court held an evidentiary hearing during which Mr. Hansen and Mr. Simpson testified. Following the hearing, the bankruptcy court took the matter under advisement, and directed the parties to submit post-trial briefs. Both parties filed posttrial briefs on December 10, 2015.

On February 5, 2016, the bankruptcy court issued oral findings of fact and conclusions of law, determining the Claims were entitled to priority as six months claims under § 1171(b). In its ruling, the bankruptcy court rejected the Appellant's contention that claims arising from interline freight services cannot, as a matter of law, qualify for priority under § 1171(b), stating:

> I read Boston [&] Maine II to have reversed the decision of the District Court, which denied priority treatment of the claims of interlining railroads which sought six-month priority status for their per diem claims. ... [A]s a matter of law, the mere fact that the claims are for interline freight services does not exclude them from possible priority consideration.

The bankruptcy court then stated "if the claimant railways can satisfy the judicially established three elements required for the 1171(b) claims [set forth in Boston & Maine II], then they're entitled to priority treatment."
Turning to the evidence, the bankruptcy court found the Claims satisfied each of the elements of the Boston & Maine II test.

As to the "necessity of the charges," the bankruptcy court looked at the testimony of Mr. Hansen and Mr. Simpson regarding the importance of the "critical rail artery" between St. John, **New Brunswick** and Montréal to MMA and found MMA's inability to interchange traffic with the Irving Railroads on that route would have had a significant adverse effect on MMA's operations, including possible loss of business with Irving Paper Companies as well as a reduction in revenue. As to this prong, the bankruptcy court concluded:

> Based upon this and the other evidence adduced at the hearing, I conclude that the claimant railways satisfied their burden on the necessity issue. I don't ascribe to the narrow view of what a necessity is. I find that [ ] sufficient claims are for a current expense, goods and services and [ ] ordinary operation of the rail.

As to the second prong—whether the Claims were incurred within six months before the petition was filed —the bankruptcy court determined there had been "no meaningful challenge" to this asserted element.

As to the third prong—whether the goods or services were delivered in the expectation that they be paid for out of MMA's current operating revenues and ***483** not in reliance on MMA's general credit—the bankruptcy court concluded:

> Based on testimony ... as well as other evidence presented at the hearing, I conclude that the claimant railways met their burden as to the third element of the 1171(b) claims. Testimony shows that, in order to keep the interchange of services going between the parties, claimant railways agreed to wait for the ISS system to process payment and then to pay ... them to MMA before MMA would pay the claimant railways. I do not conclude that this was reliance on MMA's credit, nor do I conclude that this was some sort of special security arrangement which excepts the claimant railways from the protection of the six-months rule. I didn't find anything in that deal or that arrangement that had incorporated common conditions of the commercial credit, security interests, and the like.
>
> I do not find that the existence of the Wheeling line of credit changes my conclusion. Mr. Hansen was not aware that MMA had a line of credit with Wheeling, he so testified. Mr. Simpson admitted he was aware of it "anecdotally," but had no knowledge of how it "worked," and was not familiar with it. Nobody, according to the testimony, ever advised Mr. Hansen or Mr. Simpson that MMA's ability to pay claimant railroads was dependent on MMA being able to draw on the Wheeling line of credit.
>
> So based upon the unique facts and my analysis of the equities asserted by MMA, on one hand, and [t]he claimant railroads, on the other, I conclude that the claimant railways

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have met their burden. The claims shall be allowed as 1171(b) claims.

Thereafter, the bankruptcy court entered the Order, which memorialized its ruling as follows:

> Based upon the unique facts of this matter and the Court's analysis of the equities asserted by MMA, on the one hand, and the [Irving Railroads], on the other, the [Irving Railroads] met their burden of establishing that the Asserted 1171(b) Claims qualify as claims that are entitled to priority under § 1171(b) of the Code because:
>
> (1) the Asserted 1171(b) Claims represent currentoperating expenses that were necessarily incurred by MMA in connection with its on-going operations;
>
> (2) the Asserted 1171(b) Claims were incurred withinsix months prior to the commencement of this case; and
>
> (3) the services that are the subject of the Asserted1171(b) Claims were provided to MMA with the expectation that they would be paid for out of the current operating revenues of MMA, and not in reliance on its general creditworthiness.

The Order also provided:

> The Asserted 1171(b) Claims, to the extent allowed, are afforded priority status under § 1171(b). The amount of the Asserted 1171(b) Claims is not determined by this Order, and thus those Asserted 1171(b) Claims are not allowed in any amount at this time. The [Appellant]'s rights to object to the amount of the Asserted 1171(b) Claims are fully reserved.

The Appellant timely filed a notice of appeal of the Order, and a motion for leave to appeal. The Irving Railroads filed a response to the motion for leave to appeal, stating they did not oppose the motion because they agreed the resolution of the pending appeal might advance the final disposition of litigation with the Appellant in several matters pending before the bankruptcy court. In an order dated ***484** March 29, 2016, the Panel granted the motion for leave to appeal.[10]

JURISDICTION

[1] [2] The Panel has jurisdiction to hear appeals from: (1) final judgments, orders and decrees; or (2) with leave of court, from certain interlocutory orders. 28 U.S.C. § 158(a); Fleet Data Processing Corp. v. Branch (In re Bank of New Eng. Corp.), 218 B.R. 643, 645 (1st Cir. BAP 1998). A decision is considered final if it "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." Id. at 646 (citations omitted). An interlocutory order, however, "only decides some intervening matter pertaining to the cause, and requires further steps to be taken in order to enable the court to adjudicate the cause on the merits." Id. (quoting In re American Colonial Broad. Corp., 758 F.2d 794, 801 (1st Cir. 1985)).

[3] In the Order, the bankruptcy court ruled that the Claims would be afforded priority status under § 1171(b), but it did not determine whether the Claims would be allowed and if so, in what amount. Thus, the Order did not resolve all of the issues relating to the Claims, and is interlocutory. As noted above, however, the Panel exercised its discretion under 28 U.S.C. § 158(a)(3) to hear this interlocutory appeal.

STANDARD OF REVIEW

[4] [5] The Panel reviews a bankruptcy court's findings of fact for clear error and its conclusions of law de novo. See Castellanos Grp. Law Firm, L.L.C. v. F.D.I.C. (In re MJS Las Croabas Props., Inc.), 545 B.R. 401, 417 (1st Cir. BAP 2016) (citation omitted). The question as to whether the bankruptcy court correctly held, as a matter of law, that interline freight claims may qualify for priority status under § 1171(b) if they satisfy the test adopted by the First Circuit in Boston & Maine II is a legal question which is subject to de novo review. See United States v. Cushing (In re Cushing), 401 B.R. 528, 532 (1st Cir. BAP 2009); Morad v. Xifaras (In re Morad), 323 B.R. 818, 822 (1st Cir. BAP 2005). The bankruptcy court's findings that the Claims did, in fact, satisfy each of the elements of the Boston & Maine II test are findings of fact subject to review under the clearly erroneous standard and should not be overturned unless this Panel is left with "a 'strong, unyielding belief' that the bankruptcy judge made a mistake." Sharfarz v. Goguen (In re Goguen), 691 F.3d 62, 69 (1st Cir. 2012) (quoting Cumpiano v. Banco Santander P.R., 902 F.2d 148, 152 (1st Cir. 1990)).

DISCUSSION

I. The Legal Standard

A. Claims Allowance Sections 501 and 502 govern the filing and allowance of creditor claims in bankruptcy proceedings. When a debtor files for relief, each creditor is entitled to file a proof of claim against the debtor's estate pursuant to § 501. Section 502(a) provides that a proof of claim filed under § 501 "is deemed allowed, unless a party in interest ... objects." 11 U.S.C. § 502(a). When a party in interest objects to a proof of claim, "the court, after notice and a hearing, shall determine the amount of such ***485** claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount," unless one of statutory grounds for disallowance applies. 11 U.S.C. § 502(b).

[6] "A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f); see also In re Long, 353 B.R. 1, 13 (Bankr. D. Mass. 2006) (citing Juniper Dev. Grp. v. Kahn (In re Hemingway Transp., Inc.), 993 F.2d 915, 925 (1st Cir. 1993)). In order to rebut this prima facie evidence, the objecting party must produce "substantial evidence" in opposition to it. See In re Perron, 474 B.R. 310, 313 (Bankr. D. Me. 2012) (citations omitted); In re Long, 353 B.R. at 13; see also Am. Express Bank, FSB v. Askenazier (In re Plourde), 418 B.R. 495, 504 (1st Cir. BAP 2009); United States v. Clifford (In re Clifford), 255 B.R. 258, 262 (D. Mass. 2000). If the objecting party produces substantial evidence in opposition to the proof of claim and thereby rebuts the prima facie evidence, the burden shifts to the claimant to establish the validity of its claim by a preponderance of the evidence. In re Long, 353 B.R. at 13 (citing Hemingway Transport, 993 F.2d at 925); In re Plourde, 418 B.R. at 504 (citations omitted).

Here, the Irving Railroads asserted unsecured claims, a portion of which they claimed were entitled to priority under § 1171(b). The Appellant did not challenge the Irving Railroads' assertion of unsecured claims, but rather the priority asserted in the Claims.[11] The bankruptcy court determined the Appellant put forth sufficient evidence to negate the prima facie validity of the Claims and the priority asserted for the Claims, and, therefore, the burden was on the Irving Railroads to establish that the Claims were entitled to priority under § 1171(b).

B. Claims Entitled to Priority Under § 1171(b) A fundamental principle of bankruptcy law requires that all unsecured creditors of an equal class be treated in a like manner throughout the bankruptcy proceeding. See In re CoServ, L.L.C., 273 B.R. 487, 494 (Bankr. N.D. Tex. 2002) ("[T]he entire scheme of the Bankruptcy Code favors equal (and simultaneous) treatment of equal allowed claims."). Thus, payments to unsecured creditors are distributed according to the priority schemes set forth in the Bankruptcy Code. Section 507 specifies the kinds of unsecured claims that are entitled to priority in distribution and the order of such priority. In chapter 11 cases, priority claims must be paid in full in order to confirm a reorganization plan. See 11 U.S.C. § 1129(a)(9). Although § 507 is the designated section governing priorities upon distribution of assets to unsecured creditors, however, other sections of the Bankruptcy Code relate to and may have an effect on these priorities. One such section is § 1171(b), which accords certain claims the same priority in railroad reorganization cases as would be recognized if a receiver in equity had been appointed. Section 1171(b) provides:

> Any unsecured claim against the debtor that would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the date of the order for relief under this title shall be entitled ***486** to the same priority in the case under this chapter.

11 U.S.C. § 1171(b).

Section 1171(b) codified a long-established equitable doctrine referred to as the "Six Months Rule" which developed in railroad receivership cases based on the practice of allowing railroad receivers to pay certain necessary expenses incurred in the period immediately preceding the receivership. See Boston & Maine II, 634 F.2d at 1366–1379. Under the Six Months Rule, railroad receivers were entitled to pay the unpaid claims of operations creditors arising in the six months preceding the reorganization before paying mortgagees and secured creditors, giving these claims a priority status. "The justification for [the] doctrine was that it would be inequitable to operating creditors,

supplying the necessary services and products for the railroad's continued existence and revenue generation, if the resulting operating revenue benefited secured creditors, who were not entitled to the operating revenue of the railroad until a receiver was appointed." In re Jeans.com, Inc., 502 B.R. 250, 253 (Bankr. D.P.R. 2013) (citation omitted) (internal quotations omitted). "In essence, the rule gave pre-bankruptcy unsecured claims of vendors and other operating creditors that arose within six months before the receivership priority in payment over secured creditors." Id. (citation omitted) (internal quotations omitted).

The Six Months Rule was given statutory recognition in § 77(b) of the Bankruptcy Act of 1898 ("Bankruptcy Act"), 11 U.S.C. § 205(b) (repealed 1976), and then codified in § 1171(b) of the Bankruptcy Code.[12] Although the statute does not expressly mention the Six Months Rule, it is well settled that § 1171(b) makes the doctrine applicable to railroad reorganizations and the prior equity receivership law survived enactment of the statute. See B & W Enters., Inc. v. Goodman Oil Co. (In re B & W Enters., Inc.), 713 F.2d 534, 536 (9th Cir. 1983) ("[T]here is little doubt that Congress intended that § 1171(b) operate to continue the Six Months Rule in granting certain creditors priority.") (citing H.R. Doc. No. 137, 93d Cong., 1st Sess. 424 (1978); Boston & Maine II, 634 F.2d at 1379–80 n.35; Alan N. Resnick and Henry J, Sommer, 5 Collier on Bankruptcy ¶ 1171.02 (15th ed. 1979)). Thus, the claims entitled to priority under § 1171(b) are often referred to as "six months claims."

Section 1171(b) does not, however, set forth the terms or conditions which give rise to a priority for six months claims. Thus, it was left to the courts to " 'determine the precise contours of the priority recognized by this subsection' " in each case. In re Michigan Interstate Ry. Co., 87 B.R. 921, 926 (Bankr. E.D. Mich. 1988) (quoting H.R. Rep. No. 95-595, 95th Cong. 1st Sess. at 424 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 6380). Here, the bankruptcy court determined the First Circuit's decision in Boston & Maine II sets forth the applicable standard for determining whether a claim is entitled to priority as a six months claim under § 1171(b). Thus, we turn to the First Circuit's two opinions in the Boston & Maine Corp. case.

***487 C. The Boston & Maine Corp. Decisions**

The First Circuit addressed interline claims in two appeals arising from the reorganization of the Boston & Maine Corp., formerly known as the Boston & Maine Railroad Co. The first decision, Boston & Maine I, involved an appeal from the district court's refusal to order immediate payment of pre-petition "per diem" charges owed to certain interline carriers.[13] 600 F.2d at 307. During the course of a 15-year dispute over the reasonableness of the per diem charges, the Interstate Commerce Commission (the "ICC") entered an order establishing the per diem rates that could properly be charged for the period from 1953 through August 1, 1969, and directing that interlining railroads pay per diem charges at the prescribed rates from August 1, 1969 onward.

After Boston & Maine Corp. filed its bankruptcy petition on March 12, 1970, several of its interline carriers sought an order compelling the trustee to pay immediately: (1) the difference between what Boston & Maine Corp. had actually paid for per diem charges that had accrued prior to August 1, 1969, and what should have been paid under the rates established by the ICC; and (2) per diem charges accruing on and after August 1, 1969 at the prescribed rates. The interline carriers argued that because the trustee's operation of Boston & Maine Corp. was subject to the jurisdiction of the ICC, and because the ICC had established the rates and had ordered payment of the charges at specific times, neither the trustee nor the court had discretion to defer their payment. Id. at 308.

The First Circuit rejected the interline carriers' argument, finding "there is no specific provision in either the Bankruptcy Act or the Interstate Commerce Act giving the ICC the power to override the reorganization court's discretion in setting the time for payment of claims against the estate." Id. at 310. Citing with approval the Third Circuit's decision in In re Penn Central Transportation Co., 553 F.2d 12 (3d Cir. 1977), the court held that the " 'countless financial and operating exigencies' " that arise on a daily basis in a reorganization proceeding mandate that the reorganization court be free to exercise its discretion in approving payments of prepetition obligations during the course of the proceeding. Boston & Maine I, 600 F.2d at 311–12. Based upon the circumstances present in the Boston & Maine Corp. reorganization, the court held that the district court had not abused its discretion in refusing to order the immediate payment of the pre-petition per diem charges. Id. The First Circuit did not address whether the pre-petition per diem claims of the interline carriers would qualify for priority

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status as six months claims under a plan of reorganization as might be eventually proposed in the case.

The same per diem claims were again before the First Circuit in Boston & Maine II. In that case, the interline carriers, having lost the right to immediate payment of their per diem claims at the outset of the ***488** bankruptcy, sought, among other things, priority in Boston & Maine Corp.'s plan of reorganization for $3,000,000 of their claims that had accrued within six months of bankruptcy. The district court determined their claims were not entitled to priority. See In re Boston & Me. Corp., 468 F.Supp. 996 (D. Mass. 1979). In rejecting the interline carriers' claims of priority, the district court relied upon a line of authorities that had evolved from the Supreme Court's decision in Fosdick v. Schall, 99 U.S. 235, 25 L.Ed. 339 (1879), which held that in order to qualify for priority as a six months claim, the claimant was required to establish, among other things, that the debtor railroad had generated a "current debt fund" (i.e., current earnings in excess of operating expenses) out of which priority payments could be made. 468 F.Supp. at 1002. Finding that no current debt fund existed, the district court held the interline carriers' claims did not qualify for priority under the Six Months Rule. Id. at 1008. The interline carriers appealed.

[7] Following a lengthy review of the relevant case law interpreting the equity receivership rules that had developed in railroad receiverships and incorporated in § 77(b) of the Bankruptcy Act, the First Circuit reversed, and ruled that per diem claims of interline carriers may be entitled to priority under the Six Months Rule without regard to a current debt fund. Relying upon a separate line of cases interpreting the Supreme Court's decision in Miltenberger v. Logansport Railway Co., 106 U.S. 286, 1 S.Ct. 140, 27 L.Ed. 117 (1882),[14] the First Circuit held that the district court had incorrectly required, in addition to these criteria, the existence of a current debt fund as prerequisite for according priority to these types of six months claims, stating:

> In any event, it must be concluded that the class of creditors entitled to the priority contemplated by Section 77(b) [of the Bankruptcy Act], is not limited to participation in the current debt (expense) fund defined in terms of Fosdick equitable restitution, but extends to participation in reorganization railway operating revenues essentially on the same basis as administration expenses incurred during the reorganization period.

Boston & Maine II, 634 F.2d at 1380. As the First Circuit noted: "Miltenberger [wa]s concerned, not with the 'diversion' [debt fund] precept of Fosdick, but with the more general authority of the receivership court to accord priority status to pre-receivership claims in order to prevent the ***489** stoppage of a business impressed with the public interest." Id. at 1370. Thus, the First Circuit ruled that the per diem claims of the interline carriers were entitled to priority as six months claims if each such claim met the following three criteria:

> (1) it represent[ed] a current operating expense necessarily incurred, (2) was incurred within six months before the reorganization petition was filed, and (3) the goods or services were delivered in the expectation that they would be paid for out of current operating revenues of the railroad, and not in reliance on the [rail]road's general credit ....

Id.[15]

In its opinion, the First Circuit specifically identified "interline claims" as a type of claim which could qualify for priority as a six months claim, referring to the possible "stoppage of traffic interchange" as one of the "disastrous consequences" of failing to pay such claims. Id. at 1377– 78. The court also cited with approval a number of cases which recognized interline freight claims as quintessential examples of six months claims. For example, the First Circuit cited Southern Ry. Co. v. Flournoy, 301 F.2d 847 (4th Cir. 1962), in which the Fourth Circuit emphasized that, from Miltenberger forward, "public concern with the continued operation of the railroad has been a factor supporting the priority accorded general creditors." 634 F.2d at 1375. The Fourth Circuit accorded interline traffic balances and other interline accounts a priority over the mortgage bondholders, treating the six month limitation as preventing operating claims from undermining the mortgage through secret liens. Id. The First Circuit also cited Finance Co. v. Charleston, C. & C. R. Co., 62 F. 205, 208 (4th Cir. 1894), in which the court held that interline claims for freight and freight

balances could be given priority depending upon the facts and circumstances of the particular case, and the character of the claims. 634 F.2d at 1371–72. And the First Circuit noted that in In re Tenn. Cent. Ry. Co., 316 F.Supp. 1103, 1110 (M.D. Tenn. 1970), vacated on other grounds, 463 F.2d 73 (6th Cir. 1972), the court accorded a priority for claims for interline freight balances, relying in part on the special character of interline freight balances as collections for which the railroad had to account to connecting carriers. 634 F.2d at 1376.

Having found that the district court had failed to apply the correct legal standard in considering whether the interline carriers' per diem claims were to be accorded priority as six months claims, the First Circuit remanded the case for further proceedings consistent with its opinion. Id. at 1382. On remand, the district court held, "in accordance with the principles in Boston & Maine [II]," that the interline carriers' per diem claims in the amount of $3,000,000 were to be treated as six months priority claims in the railroad's plan of reorganization, and were to be paid in full and in cash on the effective date of the plan.

See In re Boston & Me. Corp., 46 B.R. 930, 941, 956 (D. Mass. 1983).

In this case, the bankruptcy court held that the threepart test set forth in Boston & Maine II is the applicable standard in the First Circuit for determining whether the Claims were entitled to priority as six months claims under § 1171(b). Turning to the evidence, the bankruptcy court found ***490** the Claims satisfied each element of that test. The Appellant argues, however, that the Claims are not entitled to priority under § 1171(b) for several reasons. First, he argues that interline freight claims of the type asserted by the Irving Railroads are not eligible, as a matter of law, for priority under § 1171(b). Second, the Appellant contends the bankruptcy court applied incorrect legal standards and made clearly erroneous findings of fact when it determined the Claims met the three criteria set forth in Boston & Maine II.

II. Whether the bankruptcy court erred in failing to rule that interline charges are not eligible, as a matter of law, for priority under § 1171(b)?

[8] The Appellant argues that under post-Bankruptcy Code law, interline charges are general unsecured claims that are not eligible, as a matter of law, for priority under § 1171(b). In support, he relies on three decisions: Union Pac. R.R. Co. v. Moritz (In re Iowa R.R. Co.), 840 F.2d 535 (7th Cir. 1988) ("Iowa Railroad"); Howard v. Burlington N. & Santa Fe Ry. Co. (In re Bangor & Aroostook R.R. Co.), 320 B.R. 226 (Bankr. D. Me. 2005), aff'd, No. 06–141–B–H, 2007 WL 607867 (D. Me. Feb. 23, 2007) ("Bangor & Aroostook"); and In re McLean Indus. Inc., 103 B.R. 424 (Bankr. S.D.N.Y. 1989) ("McLean Industries"). The Appellant, however, fails to acknowledge that the First Circuit in Boston & Maine II specifically identified "interline claims" as one type of claim which may be eligible for priority as a six months claim if certain requirements are met. Moreover, the cases cited by the Appellant do not stand for the proposition that interline charges are ineligible, as a matter of law, for priority under § 1171(b).

In Iowa Railroad, the court addressed whether interline balances were trust funds which the debtor railroad was obligated to turn over to the interline carriers, or whether they were debt obligations owed to the carriers. The Seventh Circuit reversed the lower court's ruling that the interline freight balances were trust funds, holding instead that the relationship of the bankrupt railroad with its interline carriers was that of debtor and creditor. In so holding, the court observed:

> Interline operations have been common since the founding of American roads, so the treatment of interline balances also is an old subject. See Miltenberger v. Logansport Ry., 106 U.S. 286, 293, 1 S.Ct. 140, 27 L.Ed. 117 (1882). Until 1933, when Congress added § 77 to the old Code, 11 U.S.C. § 205 (1976), all railroad bankruptcies were handled as equity receiverships ... The rules for equity receiverships permitted courts to enhance the priority of debts incurred as operating expenses within the six months prior to insolvency or necessary to the continued operation of the debtor. See Miltenberger, 106 U.S. at 311, 1 S.Ct. 140. Courts applied these principles, without extended discussion, to interline balances. This approach assumed that interline balances are general, unsecured debts. Not until 1967 did any interline creditor argue that the balances are "trust funds" or otherwise

> entitled to priority exceeding that available to other operating expenses.

840 F.2d at 537 (citations omitted).

The court's reference to the historical assumption that interline balances are "general, unsecured debts" does not, however, establish a per se rule that those debts are ineligible for priority under current case law. Moreover, the court characterized interline balances as "general, unsecured debts" when rejecting the assertion that they should be viewed as trust funds which the debtor was obligated to immediately turn over to the interline carriers. ***491** The Iowa Railroad court did not address whether the unsecured debts owed to interline freight carriers might qualify for priority under § 1171(b), and a "per se" ineligibility rule is an unwarranted interpretation of the court's discussion.

Similarly, the Bangor & Aroostook court did not address whether interline freight claims qualify for priority under § 1171(b). In Bangor & Aroostook, the trustee brought a preference action against a number of interline carriers which, through setoffs exercised within 90 days prior to the commencement of bankruptcy, had collected freight charges owed to them by the debtor. The interline carriers moved for summary judgment on the basis that the interline freight balances owed to them were trust funds. The court, relying in large part on Iowa Railroad, held that the interline carriers were "creditors, rather than trust beneficiaries" and denied their motions for summary judgment. 320 B.R. at 242. The court did not discuss whether the interline claims at issue might qualify for priority under § 1171(b). The Appellant argues, however, that if the Bangor & Aroostook court believed the interline creditors held priority six months claims, "the court would have granted the interline creditor[s] summary judgment." By declining to grant summary judgment, the Appellant infers that the court determined the interline creditors to have general unsecured claims as a matter of law. Such an argument is based on mere conjecture and lacks merit. Preference actions are rarely decided on a motion for summary judgment due to their factual nature, and, therefore, the Bangor & Aroostook court's failure to grant summary judgment is not support for a rule that interline creditors were ineligible, as a matter of law, to assert priority as six months claims.

The Appellant's reliance on McLean Industries also is misplaced. The debtor in McLean Industries was a steamship company, not a railroad, and therefore, the court held, § 1171(b) did not apply to the claims in that case. Thus, McLean Industries stands for the proposition that the Six Months Rule of priority does not apply in a non-railroad chapter 11 case. The Appellant, however, focuses upon the following dicta in the opinion to support his contention that in enacting the current version of the Bankruptcy Code, Congress "addressed and rejected the priority that the Bankruptcy Court afforded the Irving Railroads."

> Congress, in enacting the Bankruptcy Code, expressly rejected a proposal that debtor railroads be required to pay interline balances stating that to do so would distort the central bankruptcy principle of equality of treatment of unsecured creditors.

103 B.R. at 426 (citation omitted).

[9] [10] [11] From that statement, the Appellant concludes that Congress rejected § 1171(b) priority for interline freight claims. The Appellant's interpretation, however, reflects his misreading of the legislative history leading up to enactment of the Bankruptcy Code. The relevant legislative history demonstrates Congress did not reject a proposal establishing priority status for interline freight claims.[16]

***492** Prior to the enactment of the Bankruptcy Code, there was a split among the circuits on the question of whether a railroad reorganization trustee had authority, without first seeking court approval, to pay interline balances when they came due under ICC rules. In In re Penn Central Transp. Co., 486 F.2d 519 (3d Cir. 1973), and later in In re Penn Central Transp. Co., supra, the Third Circuit held that a trustee was not empowered to make immediate payment of interline balances absent authorization from the court. The Seventh Circuit came to the opposite conclusion in Chicago, Rock Island & Pacific R.R. Co. v. Atchison, Topeka & Santa Fe Railway Co., 537 F.2d 906 (7th Cir. 1976) ("Rock Island"), holding that a trustee is bound by ICC rules to pay interline claims immediately as they come due, without the need for court authorization.

During the legislative process that resulted in the passage of the Bankruptcy Reform Act of 1978, Pub. L. 95– 598, Nov. 6, 1978, 92 Stat. 2643, the bankruptcy bill introduced

in the Senate, S. 2266, 95th Cong. (1977), contained provisions which would have codified the Seventh Circuit's holding in Rock Island by providing authority to a railroad's trustee to pay all pre-bankruptcy interline balances without the need for court approval. The House version of the bankruptcy bill did not contain these provisions and in enacting the Bankruptcy Code the Senate capitulated. As explained by the Seventh Circuit in Boston & Maine Corp. v. Chicago Pacific Corp., 785 F.2d 562 (7th Cir. 1986), which the McLean Industries court relied upon when making its statement regarding Congressional intent:

> Congress rejected our holding [in Rock Island] that the rules of the ICC, rather than principles of bankruptcy, should govern the question of whether prereorganization per diem charges should be *paid immediately*.

785 F.2d at 568–69 (emphasis added).

The provisions in the Senate bill rejected by Congress in enacting the Bankruptcy Code dealt only with the issue of whether interline charges could be *paid immediately* during the course of the bankruptcy, pursuant to ICC orders or rules, without the need for bankruptcy court approval. See S. 2266, § 1169. They did not address the priority to which such claims were entitled under a plan of reorganization, which is the issue to be resolved in this appeal. That issue is addressed by § 1171(b), and the equity receivership rules which Congress incorporated into § 1171(b).

For the reasons set forth above, we are not persuaded by the cases cited by the Appellant and conclude the bankruptcy court did not err when it failed to rule that interline charges are not eligible, as a matter of law, for priority as six months claims under § 1171(b). Rather, the bankruptcy court correctly ruled that the Claims could qualify for priority status under § 1171(b) if they satisfied the three-part test set forth in Boston & Maine II.

III. Whether the bankruptcy court erred in ruling that the Claims satisfied the Boston & Maine II test?

The Appellant does not challenge the bankruptcy court's determination that the Irving Railroads met their burden of establishing the Claims were incurred within the sixmonth period preceding the bankruptcy ***493** filing. Thus, the focus in this appeal is on the other criteria under the Boston & Maine II test—whether the Claims were for a good or service, whether they represent current operating expenses necessarily incurred, and whether the services were delivered by the Irving Railroads with the expectation that they would be paid for out of MMA's current operating revenues of the railroad, and not in reliance on MMA's general credit.

A. Were the Claims for a good or service?

[12] The Appellant argues the bankruptcy court erred by failing to consider his argument that the Claims did not involve a "good or service," as required under the Boston & Maine II test, and because the Irving Railroads failed to meet their burden of proof on this issue. The Appellant argued below that the Irving Railroads did not provide a "good or service" because MMA's interchange of freight with the Irving Railroads involved nothing more than permission for MMA to use Irving Railroads' tracks for a fee.

Although the bankruptcy court did not expressly address the Appellant's contention in its oral ruling, it found that the Irving Railroads provided freight services to MMA that were more than mere use of their tracks. The bankruptcy court specifically noted Mr. Hansen's testimony at the trial regarding the nature of the freight services provided by the Irving Railroads as they related to oil shipments, finding as follows:

> Beginning in 2012, the amounts owed by MMA for interline freight services provided by the claimant railways began to exceed the amounts owed by Irving to MMA. As Mr. Hansen put it at trial, "Well, the shipment of oil would have been coming out of the Dakotas by [CP]. They would hit MMA's line, They would interchange with MMA, Then the oil would come—the train would come down through until it hit NB Southern [NBSR]'s line, *NB Southern [NBSR] would transport it from then into St. John,* ***New Brunswick****."*

(emphasis added). Thus, the court expressly acknowledged that the Irving Railroads provided interline freight services to MMA and, specifically, that the Irving Railroads transported freight into St. John, **New Brunswick**. The bankruptcy court also recognized Mr. Simpson's testimony at the trial regarding "the freight services provided to MMA." Mr. Simpson explained that, with respect to freight carried by MMA to the interchange point with the Irving Railroads, the interchange of freight traffic involved the de-coupling of freight cars from MMA's locomotives and connecting them to the Irving

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Railroads' locomotives, which then carried the freight cars to their final destination. The bankruptcy court specifically found that Mr. Simpson's "persuasive testimony" regarding the freight services provided to MMA was uncontroverted.

In his brief on appeal, the Appellant reasserts his contention that the freight services which were the basis for the Claims "consisted largely, if not entirely, of use of the track of the Irving Railroads by MMA." He does not, however, point to any evidence to support his contention. Rather, he argues that the bankruptcy court erred because the Claims originated, in part, from MMA's "role as collection agent for the Irving Railroads and its subsequent failure to remit amounts collected," rather than from any good or service provided to MMA.

Although the bankruptcy court did not specifically address this argument in its oral ruling, the issue was squarely determined by the bankruptcy court when it found, based on the evidence presented at ***494** the hearing, that the Irving Railroads provided freight services to MMA in accordance with the agreement between the parties. The record supports the bankruptcy court's ruling.

In considering the Appellant's argument that the bankruptcy court erred in this finding, we review how railway freight shipping operates. "The nation's railroads function in many ways as a single system." In re Penn Cent. Transp. Co., 486 F.2d at 521. The Bangor & Aroostook court described the system as follows:

> Shipping freight any distance by rail generally requires the services of several railroad lines. Shipments come and go throughout the country, originating and traveling on multiple railroads. Shippers routinely pay one carrier (the "collecting carrier") a charge for the entire journey. That amount includes the charges of each railroad along the way. Thus, with regard to inter-line shipments, each railroad may be at once the collecting carrier for some, receiving funds and accruing obligations to participating carriers; and for others a participating carrier, accruing rights to freight charges for shipments which travel over its rails.

320 B.R. at 228. Under this system, "[e]ach interline freight shipment triggers charges attributable to the services provided by each of several railroads." Id. at 231. "The collecting railroad takes in the entire fare—and owes prescribed portions of it to each participating carrier." Id. "That there are multiple shipments and multiple parties is of no moment. The circumstances reduce to sets of bilateral relationships in which one railroad owes freight charges to another, and the second owes freight charges back to the first." Id.

The bankruptcy court found that the ISS provides a central clearing house for all participating railroads involved in the interchange of freight traffic among multiple rail carriers to settle accounts receivable and accounts payable arising from the interchange of such traffic. Because the Irving Railroads were not members of the ISS, they needed MMA to serve as their "front man," not only for the purpose of assessing and collecting the total amount of freight charges that otherwise would have been paid directly to the Irving Railroads for its transportation services, but also to negotiate freight rates, make contracts, and provide quotations for services to be rendered. The Commercial Agreement provides clear evidence that the Irving Railroads were providing "transportation services" to MMA. The stated purpose of the Commercial Agreement was "to establish the hauling of freight for MMA." Moreover, Section 2 set forth the agreement between the parties regarding Irving Railroads' "Performance of Transportation Services":

> The parties agree that from and after the Effective Date, [the Irving Railroads] shall move loaded freight cars and associated empty cars between points located on its lines or reached by it under Canadian interswitch rules and Brownville Junction at rates as set out in this Agreement. MMA shall act as the interline tariff carrier on a junction settlement basis. By "junction settlement basis" the parties mean that MMA shall negotiate through rates and make contracts and provide quotations, and shall be responsible for car supply to the extent requested by NB[R]S and reasonably available from MMA and in rail cars customarily supplied by railroad carriers, all in accordance with the provisions of this Agreement. MMA

> shall continue to render one freight bill, and assess and collect the total amount of freight charges ... and *remit the portion pertaining to [the Irving Railroads'] transportation services to [the* ***495** *Irving Railroads]* in accordance with the procedures in this Agreement.

(emphasis added). Thus, although MMA acted, in part, as the billing railroad and, therefore, collected payments either directly from the customer or from the ISS, that does not change the nature of the services provided by the Irving Railroads to MMA.

Based on the foregoing, the record supports the bankruptcy court's finding that the Irving Railroads provided services to MMA by shipping freight across its railway lines pursuant to its agreement with MMA, and, therefore, the "freight charges," which are the basis of the Claims, all originated from the Irving Railroads' *service* of shipping freight pursuant to its agreement with MMA. Therefore, the bankruptcy court did not err in finding that the Claims satisfied this requirement of the Boston & Maine II test.

B. Were the Claims for "current operating expenses necessarily incurred" by MMA?

[13] [14] [15] To qualify for priority under § 1171(b), the Claims must be for current operating expenses necessarily incurred by MMA in connection with its rail operations. The Appellant asserts an operating expense is "necessary" for purposes of § 1171(b) "when its nonpayment would cause the debtor railroad to cease, or clearly risk cessation of, operations." Thus, the Appellant maintains, claims satisfy this prong of the § 1171(b) test if they arise from goods or services that are "indispensable to the continued performance of the transportation service." The Appellant argues the bankruptcy court applied an improper legal standard because it held that the Claims need only be for "current operating expenses," rather than considering whether the services provided by the Irving Railroads were "indispensable" to MMA's business as a going concern. And, he contends, the services Irving Railroads provided to MMA were not "necessary" or "indispensable" because the Irving Railroads' refusal to interchange freight with MMA would not have shut down MMA's rail operations, and because they were required by ICC rules to accept the interchange of traffic from MMA.

As to the applicable legal standard, the Appellant's articulation of an "end of the world" or "doomsday" standard appears to be at odds with that articulated by the First Circuit in Boston & Maine II. In Boston & Maine II, the First Circuit indicated the test is not whether the individual claimant has the power to shut down the operation of the railroad, but whether the claim falls within a "class of claims" which are indispensable to the operation of the business. 634 F.2d at 1377–78. In addressing the Supreme Court's decision in Miltenberger, which held that interline freight claims were eligible for immediate payment, the First Circuit observed:

> The [Miltenberger] Court's rationale excludes the inference that only those creditors are entitled to priority of payment who demand immediate payment as a condition of continuing to supply a service or commodity of which they are monopolists. The Court was defining the *classes* of claims payment of which was indispensable to the business of the [rail]road and which, "unless the receiver was authorized to provide for them at once, the business of the [rail]road would suffer great detriment." [106 U.S.] at 311, 1 S.Ct. 140.

Boston & Maine II, 634 F.2d at 1377 (emphasis added) (footnote omitted) (citation omitted).

The First Circuit went on to identify interline claims as one of the "classes of claims" that qualify for priority:

> ***496** The [Miltenberger] Court's depiction of the disastrous consequences of failing to pay labor claims—a work stoppage— or *interline claims—a stoppage of traffic interchange* —is directed to restricting the class of claims entitled to priority of payment to claims for those goods and services that are indispensable to the continued performance of the transportation service. ... *The test is not whether the claimant has the naked power to exert economic duress, but whether the expenses have the characteristics of those that the receiver pays from revenue as expenses of administration. ...*

Id. at 1377–78 (emphasis added) (footnote omitted) (citation omitted). Thus, the First Circuit has specifically recognized that the interchanging of freight among railroads is indispensable to the continued performance of a railroad's operations and, therefore, that interline claims such as those asserted in the Claims fall within the "class of claims" which are entitled to priority under § 1171(b). As a result, we conclude the bankruptcy court did not err by declining to adopt the Appellant's "doomsday" approach to determining whether the Claims were for "current operating expenses necessarily incurred" by MMA.

The bankruptcy court found, based on the testimony of Mr. Hansen and Mr. Simpson, as well as the statements in the Disclosure Statement, that the Irving Railroads met their burden of establishing that the Claims satisfied the "necessity" element of the Boston & Maine II test. The evidence supports the bankruptcy court's finding. As the bankruptcy court noted, in the Disclosure Statement, the Appellant acknowledged the importance of the rail route serviced by MMA and the Irving Railroads as being "[t]he shortest rail transportation route between Maine and Montréal and a critical rail artery between Saint John, New Brunswick and Montréal." That route provided outlets for, among others, "major producers of paper, lumber, wood and agricultural products in eastern and northern Maine," and "[i]n-bound transportation for chemicals and other products used by paper producers and consumers in Maine." Thus, there was a public interest in continued rail service along this route. The bankruptcy court also found that the evidence established the importance of that "critical rail artery" to MMA's business operations. As the Appellant explained in the Disclosure Statement:

> In the two years leading up to the commencement of the Chapter 11 case, the Debtor had benefited from the dramatic increased use of trains to move oil from the central and western regions of the United States, specifically, the Bakken oil fields in North Dakota, to refineries in the east. United States and Canadian oil drillers were producing oil faster than new pipelines could be built, and trains were needed to transport crude oil to refiners. Prior to the Derailment, the Debtor had been hauling about 500,000 barrels of oil monthly through Québec and Maine. Due to this business, the Debtor enjoyed a significant increase in gross revenue, and, for a short time, positive net operating income, although needed capital expenditures remained deferred and unfunded.

As the bankruptcy court noted, Mr. Simpson confirmed the importance of the rail artery between Montréal and Saint John, New Brunswick to MMA, characterizing it as the most direct, economical and practical route for the shipment of oil to refineries in Saint John, New Brunswick.

The Appellant argues, however, that the services provided by the Irving Railroads were not really necessary to MMA's operations, because if the Irving Railroads refused to accept an interchange of traffic ***497** from MMA, there were alternate routes that could have been pursued. The bankruptcy court rejected this argument, however, as the evidence showed that without being able to interchange traffic with the Irving Railroads, MMA lost essentially the entire St. John, New Brunswick market, which is where the oil that was being produced in North Dakota was being transported to over several years, prior to the derailment, and which was a source of tremendous revenue for MMA. If MMA would have been forced to choose alternative routes, they would not have been competitive in terms of being able to successfully obtain the business from the shippers in North Dakota, and they would have lost that particular business. There simply was no practical way for them to deliver the oil to St. John, New Brunswick without interchanging with the Irving Railroads. This would have had a substantial negative impact on MMA's operations. The bankruptcy court also pointed to testimony at the hearing which established that the inability of MMA to interchange traffic with the Irving Railroads would have had a significant adverse impact on MMA's operations, including, among other things, the loss of business with the Irving Paper Companies, which were among MMA's largest customers, and a substantial reduction in revenue generated from the shipment of oil to the refineries in Saint John, New Brunswick.

The Appellant also argues that the Claims were not "necessary" because the Irving Railroads were required under applicable provisions of federal transportation law to accept the interchange of traffic from MMA. As the First Circuit remarked

in Boston & Maine II, "the interlining of freight cars is mandatory under the Interstate Commerce Act, 49 U.S.C. [§§] 1(4), (10), (11), (14), (15), and (17)." 634 F.2d at 1362. Notwithstanding the requirement under the Interstate Commerce Act that railroads interline freight cars with Boston & Maine Corp., the First Circuit held their per diem claims were, nonetheless, entitled to priority as six months claims. Thus, the Appellant's argument that the Claims are not entitled to priority status because the Irving Railroads were required to accept the interchange of freight traffic is unpersuasive. Moreover, the inability of a railroad to refuse to interchange freight traffic under the ICC underscores how essential the interchange of freight traffic is to the railroad freight shipping system.

In light of the foregoing, we conclude the bankruptcy court applied the correct legal standard for determining whether the Claims were for operating expenses necessarily incurred in connection with MMA's rail operations, and the bankruptcy court did not err in determining that the Claims satisfied this part of the test.

C. Did the Irving Railroads deliver services to MMA with the expectation they would be paid from MMA's current operating revenue rather than relying on MMA's creditworthiness?

[16] The Appellant contends the bankruptcy court applied an improper legal standard in determining that the Claims satisfied this part of the § 1171(b) test. According to the Appellant, "creditors with 'special security arrangements' do not benefit from the protections afforded six months creditors because the presence of such arrangements negates any possibility of reliance only upon immediate cash flow." Therefore, he argues, the alleged "triangular setoff" arrangement between the parties establishes, as a matter of law, that the Irving Railroads provided services to MMA in reliance upon MMA's general creditworthiness rather than with the expectation that payment would be made from current operating revenue. He maintains ***498** the bankruptcy court applied the wrong standard because it held that to disqualify a claim from § 1171(b) priority status, the "special security arrangement" must qualify as a security interest under the Uniform Commercial Code. The Appellant further argues that, based upon the application of the wrong legal standard, the bankruptcy court erred in finding that the Irving Railroads provided services to MMA with the expectation that payment would be made from current operating revenue, rather than in reliance on MMA's general credit.

Again we turn to Boston & Maine II for guidance on the standard to be applied. The First Circuit articulated the standard as follows:

> [W]hen the time comes to determine membership in the class it will be for the reorganization court to determine ... whether the non-payment reflects an intentional extension of credit of the railroad, or the intervention of the reorganization petition before expiration of the ordinary billing and payment period, or some noncontractual indulgence or inadvertence on the part of the claimant, or deferment of payment on the part of the railroad; and whether, if the transaction giving rise to the claim had any credit term, it was compatible with a general expectation of payment from current receipts or indicated reliance on the railroad's general credit.

Id. at 1379–80 (footnote omitted).

The Appellant asserts, however, the bankruptcy court went further, and held, as a matter of law, that the *only* security arrangement that would disqualify a creditor from the protection of § 1171(b) is one in which "the would-be 1171(b) creditor enjoys a 'commercial credit[ ] security interest[ ].' " In advancing this argument, the Appellant has misrepresented the bankruptcy court's ruling. In ruling that the Irving Railways had met their burden of establishing that services were provided with the expectation that they would be paid from current operating revenues, as opposed to MMA's general creditworthiness, the bankruptcy court singled out those services related to oil shipments interchanged by MMA with the Irving Railroads, which were not part of the payment swap arrangement, and stated:

> Testimony shows that, in order to keep the interchange of services going between the parties, claimant railways agreed to wait for the ISS system to process payment and then to pay—the

> ISS to pay them to MMA before MMA would pay the claimant railways. I do not conclude that this was reliance on MMA's credit, nor do I conclude that this was some sort of special security arrangement which excepts the claimant railways from the protection of the six-months rule. I didn't find anything in that deal or that arrangement that had incorporated common conditions of the commercial credit, security interests, and the like.

The arrangement the bankruptcy court was discussing was completely separate from the payment swap arrangement that the Appellant characterizes as a "triangular setoff." The bankruptcy court simply found, based on the evidence presented, that nothing in the agreement of the parties covering oil shipments incorporated characteristics of general credit extension or special security arrangements. Thus, the bankruptcy court did not hold as a matter of law that only an Article 9 security interest would disqualify a claim from receiving § 1171(b) priority and, therefore, applied the correct legal standard.

The Appellant also argues that the bankruptcy court ignored the Irving Railroads' extension of credit and clearly erred in finding that they relied on ***499** MMA's current operating revenues. The Appellant contends the Irving Railroads knowingly extended credit to MMA and then mitigated the credit risk they willingly assumed by unilaterally establishing a system of triangular setoffs using payables owed to MMA by the Irving Railroads and Irving Paper Companies as collateral to secure the payment of MMA's obligations to the Irving Railroads. He also argues the Irving Railroads relied entirely on that collateral and not on MMA's cash flow in securing such payments until they found themselves "undercollateralized," at which time they agreed to an additional payment arrangement pursuant to which MMA would collect amounts through the ISS system for their benefit and remit them on agreed credit terms.

Contrary to the Appellant's assertions, the bankruptcy court's findings are supported by the record. The evidence presented at the hearing showed that, from the inception of their business relationship with MMA, the Irving Railroads were not willing to rely on the creditworthiness of MMA, which was the successor to the bankrupt Bangor & Aroostook railroad. Mr. Hansen testified that the Irving Railroads did not in any way rely on MMA's general creditworthiness, stating:

> Q: Mr. Hansen, in providing freight services in connection with the interchange of traffic with the MMA did the Irving [R]ailroads rely upon MMA's general creditworthiness?
>
> A: Absolutely not.
>
> Q: What did the Irving [R]ailroads rely upon?
>
> A: We relied on them being paid out of the ISS system, which I felt was secure, and that meant I would be paid shortly thereafter.
>
> Q: And were you secure that they could rely upon receiving money from the ISS system?
>
> A: That is correct.

The evidence showed MMA acquired its assets from Bangor & Aroostook out of bankruptcy, and there was a troubled history with respect to that railroad. Mr. Hansen testified that, in order to avoid taking any credit risk, he created a "swap" arrangement with MMA that involved the Irving Paper Companies, which were affiliated with the Irving Railroads and were among the largest customers of MMA. Pursuant to this arrangement, the parties, on a weekly basis, would simultaneously exchange wire transfers of the amounts each owed to the other. Often, the payments for freight services that MMA owed the Irving Railroads actually involved freight from the Irving Paper Companies that was being delivered from their mills in Canada to other destinations. With this arrangement, he stated, the Irving Railroads were not relying on the general creditworthiness of MMA. Rather, the source of the payment for the Irving Railroads was essentially the cash that was being paid to MMA by the Irving Paper Companies. Moreover, Mr. Hansen testified that, although the Irving Railroads may have had the ability to set off the amounts owed to MMA from the amounts MMA owed to it, they never did so.

Thus, the bankruptcy court's findings are supported by the record.

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CONCLUSION

For the reasons set forth above, we conclude the bankruptcy court did not err in ruling that the Claims qualified as six months claims entitled to priority under § 1171(b). Thus, we **AFFIRM** the Order.

All Citations

558 B.R. 473

Footnotes

1 The Appellant states that in accordance with the Trustee's Revised First Amended Plan of Liquidation Dated July 15, 2015 (as amended on October 8, 2015) (the “Plan”), upon the effective date of the Plan (which occurred on December 22, 2015), he is no longer the chapter 11 trustee of the bankruptcy estate, but is the Estate Representative of the PostEffective Date Estate (as defined in the Plan). He further states that, as the Estate Representative, he acquired all rights and duties with respect to the prosecution of this appeal and its underlying claims. The appellees do not challenge these averments.

2 Unless expressly stated otherwise, all references to “Bankruptcy Code” or to specific statutory sections shall be to the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. §§ 101, et seq.

3 MMA was formed in 2003 to acquire the assets of the Bangor & Aroostook Railroad Company and its affiliated railways (“Bangor & Aroostook”) from their bankruptcy estates. MMA commenced rail operations in January 2003.

4 NBSR operated various railroad lines in New Brunswick. EMR operated a railroad line in Maine which connected with NBSR's lines. EMR is a “sister company” of NBSR.

5 According to Mr. Simpson, the Irving Railroads did not participate in the ISS for several reasons, including lack of resources and the existence of relationships with other carriers that rendered participation in the ISS unnecessary. He also testified the decision not to participate in the ISS was not influenced in any way by the credit worthiness of MMA.

6 The Appellant characterizes this arrangement as a “triangular setoff,” contending the Irving Paper Companies would “withhold payment” on MMA's accounts receivable until MMA agreed to pay the Irving Railroads and, therefore, those payments acted as “collateral for ... a secured credit relationship.” The Irving Railroads disagree with that characterization, contending they concurrently exchanged wire transfers of cash with MMA on the settlement date and, therefore, the arrangement was a “cash swap.” The bankruptcy court referred to the arrangement as a “weekly payment swap system,” finding the transfers were done “virtually simultaneously.” At the hearing, Mr. Hansen testified that if MMA did not pay,

he would have “held the wire” but he would not have offset the amount owed by MMA from the amounts the Irving Paper Companies owed MMA because it was “too messy” from an accounting perspective.

7 It is undisputed that Irving Oil is not affiliated with the Irving Railroads or the Irving Paper Companies.

8 MNR also filed Proof of Claim No. 242–1, which was identical to Claim 257-1, and NBSR filed Proof of Claim 243-1, which was identical to Claim 259-1. The Appellant objected to Claim Nos. 242–1 and 243–1 on the grounds that they were duplicate claims and should be disallowed in their entirety. Prior to the hearing on the Appellant's objection, MNR and NBSR withdrew the duplicate claims. Therefore, they were not at issue before the bankruptcy court, and are not at issue in this appeal.

9 In the Disclosure Statement, the Appellant indicated that the Plan was a plan of liquidation of MMA's assets, as well as a plan which created and distributed a substantial settlement fund for the benefit of all victims of the derailment.

10 The Panel exercised its discretion under 28 U.S.C. § 158(a)(3) to hear this interlocutory appeal because the Order involved a controlling issue of law, and because both parties agreed that resolution of this appeal could materially advance the ultimate termination of the claims adjudication process and the preference litigation pending in the bankruptcy court.

11 Pursuant to the Order, the Appellant also reserved his right to object to the *amount* of the Claims.

12 The language of § 1171(b) is substantively the same as that of § 77(b) for the former Bankruptcy Act. Moreover, the legislative history of this section indicates that it is an expansion of the priorities afforded under § 507. The Senate Report on § 1171(b) indicates that the priority traditionally accorded by § 77(b) of the former Bankruptcy Act is a priority for

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"claims by rail creditors for necessary services rendered during the 6 months preceding the filing of the petition in bankruptcy." S. Rep. No. 95-989, 95th Cong. 2d Sess. at 135, 136 (1978).

13 The practice of "interlining" freight cars means loaning cars to one another rather than loading and unloading freight every time a shipment passes onto rails belonging to a different railroad. Boston & Maine I, 600 F.2d at 307. "Per diem" charges are charges owed by one railroad to another railroad for the use of that railroad's cars in connection with the interline shipment of freight. Id. The Appellant conceded below that per diem charges and interline freight charges are functionally equivalent for purposes of determining priority under § 1171(b). See Trustee's Claims Objection at 10 ("Interline rail shipments are in the nature of 'per diem' charges under an interline settlement system like the ISS."). Thus, the Boston & Maine Corp. decisions are relevant to our inquiry.

14 Miltenberger is the seminal case on the Necessity of Payment Rule, which is another principle of railroad receiverships and is often confused with the Six Months Rule. Whereas the Six Months Rule is a rule of priority, the Necessity of Payment Rule is one of payment. See In re Boston & Me. Corp., 468 F.Supp. at 1008. This rule developed to allow trustees to pay pre-petition debts under threats of creditors in order to obtain continued supplies or services essential to the continued operation of the debtor's business. See In re B & W Enters., Inc., 713 F.2d at 537. Miltenberger involved an appeal of an order directing a railroad receiver's immediate payment of certain pre-receivership claims. In Miltenberger, interline railroads threatened to cease furnishing supplies and interline traffic exchanges unless the railroad receiver immediately paid pre-receivership claims. The Supreme Court affirmed the circuit court order directing the railroad receiver to pay the pre-receivership claims prior to reorganization. In approving the payments, the Court gave the following justification: "Many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property, for the receiver to pay pre-existing debts ... where a stoppage of the continuance of such business relations would be a probable result, in case of non-payment." 106 U.S. at 312, 1 S.Ct. 140.

15 Other courts have similarly recognized these three criteria for priority as a six months claim. See, e.g., In re Mich. Interstate Ry. Co., 87 B.R. at 922–26; see also In re **New** York, **New** Haven & Hartford. R.R. Co., 278 F.Supp. 592, 596 (D. Conn. 1967). Courts differ, however, as to whether claimants are entitled to establish any additional elements, such as the existence of a "current debt fund" as set forth in Fosdick and its progeny.

16 "[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there." Conn. Nat'l Bank v. Germain, 503 U.S. 249, 253–54, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992) (collecting authorities). Thus, if the statutory language is unambiguous, the court need not resort to legislative history to construe the plain text of the statute. Where statutory language is ambiguous, however, courts look to the statute's "historical context, its legislative history, and the underlying policies that animate its provisions" to determine legislative intent. Marrama v. Citizens Bank of Mass. (In re Marrama), 430 F.3d 474, 480 (1st Cir. 2005) (quoting United States v. Yellin (In re Weinstein), 272 F.3d 39, 48 (1st Cir. 2001)), aff'd, 549 U.S. 365, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007). As the body of case law reflects, the language of § 1171(b) is not unambiguous and, therefore, it is appropriate to look to the legislative history.

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558 B.R. 500
United States Bankruptcy
Appellate Panel of the First Circuit.

Old Cold, LLC, f/k/a Tempnology, LLC, Debtor.
Mission Product Holdings, Inc., Appellant,
v.
Old Cold, LLC and Schleicher & Stebbins
Hotels, L.L.C., Appellees.

BAP NO. NH
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069
|
Bankruptcy Case No. 15-11400-JMD
|
October 25, 2016

Synopsis
Background: Following auction, Chapter 11 debtor limited liability company (LLC) sought order authorizing sale of substantially all of debtor's assets to successful bidder. The United States Bankruptcy Court for the District of New Hampshire, J. Michael Deasy, J., 542 B.R. 50, approved the sale. Unsuccessful bidder appealed.

Holdings: The Bankruptcy Appellate Panel, Lamoutte, J., held that:

[1] unsuccessful bidder's appeal was not statutorily moot;

[2] unsuccessful bidder's appeal was not equitably moot;

[3] bankruptcy court did not clearly err in finding thatsuccessful bidder was a good faith purchaser; and

[4] bankruptcy court applied appropriate level ofheightened scrutiny to sale.

Affirmed.

West Headnotes (19)

[1] Bankruptcy

Finality

In the bankruptcy context, an order is "final" for purposes of appeal if it completely resolves all the issues pertaining to a discrete dispute within the larger proceeding. 28 U.S.C.A. § 158(a)(1).

Cases that cite this headnote

[2] Federal Courts

Mootness

Mootness is a threshold jurisdictional issue.

Cases that cite this headnote

[3] Bankruptcy

Effect of want of stay; c onclusiveness of sale

When an order confirming a sale to a good faith purchaser is entered and a stay of that sale is not obtained, the sale becomes final and cannot be reversed on appeal. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

[4] Bankruptcy

Effect of want of stay; c onclusiveness of sale

Sale of estate property to a purchaser acting in good faith may not be reversed on appeal unless the aggrieved party obtains a stay of the sale. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

[5] Bankruptcy

Effect of want of stay; c onclusiveness of sale

Bankruptcy

Moot questions

Although unsuccessful bidder failed to obtain a stay of order authorizing sale of estate property pending appeal, its appeal was not statutorily moot to the

extent it challenged the good faith status of successful bidder. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

[6] Bankruptcy

Effect of want of stay; c onclusiveness of sale

Bankruptcy

Moot questions

Doctrine of equitable mootness allows an appellate court to dismiss a bankruptcy appeal if an unwarranted or repeated failure to request a stay enabled developments to evolve in reliance on the bankruptcy court order to the degree that their remediation has become impracticable or impossible, or if the challenged bankruptcy court order has been implemented to the degree that meaningful appellate relief is no longer practicable even though the appellant may have sought a stay with all due diligence.

Cases that cite this headnote

[7] Bankruptcy

Effect of want of stay; c onclusiveness of sale

Bankruptcy

Moot questions

Although failure to seek a stay of order authorizing sale of estate property pending appeal weighs in favor of finding mootness, it is insufficient on its own to render the appeal equitably moot; the court must consider pragmatic considerations, specifically, whether granting appellate relief would adversely affect third parties regardless of whether the appellant sought a stay, or is impracticable because of the extent to which the order has been implemented. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

[8] Bankruptcy

Effect of want of stay; c onclusiveness of sale

Bankruptcy

Moot questions

Although unsuccessful bidder failed to obtain a stay of order authorizing sale of estate property pending appeal, its appeal challenging the good faith status of successful bidder was not equitably moot; transactions which had occurred since the closing of the sale were not incapable of being unwound, as there had been no third party reliance and there was no third party that would suffer from reversal because the sale itself was no more than a change in entity. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

[9] Bankruptcy

Conclusions of law; d e novo review

Bankruptcy

Clear error

Bankruptcy Appellate Panel (BAP) reviews a bankruptcy court's findings of fact for clear error and its conclusion of law de novo.

Cases that cite this headnote

[10] Bankruptcy

Questions of law or fact

“Good faith,” for purpose of Bankruptcy Code provision precluding, in absence of stay, appellate relief invalidating sale to “good faith” purchaser, is a mixed question of law and fact. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

[11] Bankruptcy

Questions of law or fact

Mixed question of law and fact is subject to the clearly erroneous standard, unless the bankruptcy court's analysis was infected by legal error.

Cases that cite this headnote

[12] Bankruptcy

Clear error

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Bankruptcy court findings will be considered clearly erroneous if, after a review of the entire record, reviewing court is left with the definite and firm conviction that a mistake has been committed.

Cases that cite this headnote

[13] Bankruptcy

Clear error

If two views of the evidence are possible, the bankruptcy court's choice between them cannot be clearly erroneous.

Cases that cite this headnote

[14] Bankruptcy

Effect of want of stay; c onclusiveness of sale

For purposes of Bankruptcy Code section providing that sale to good faith purchaser which is approved by bankruptcy court is final and cannot be reversed unless sale is stayed pending appeal, "good faith" of buyer concerns integrity of buyer's conduct during the sales process. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

[15] Bankruptcy

Effect of want of stay; c onclusiveness of sale

Typically, the misconduct that would destroy a purchaser's good faith status, for purposes of Bankruptcy Code section providing that sale to good faith purchaser which is approved by bankruptcy court is final and cannot be reversed unless sale is stayed pending appeal, involves fraud, collusion between the purchaser and other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

[16] Bankruptcy

Effect of want of stay; c onclusiveness of sale

Mere allegations of collusion, without convincing direct evidence, are insufficient to establish lack of purchaser's good faith status, for purposes of Bankruptcy Code section providing that sale to good faith purchaser which is approved by bankruptcy court is final and cannot be reversed unless sale is stayed pending appeal. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

[17] Bankruptcy

Effect of want of stay; c onclusiveness of sale

Party's status as an insider does not automatically prevent it from being a purchaser in good faith, for purposes of Bankruptcy Code section providing that sale to good faith purchaser which is approved by bankruptcy court is final and cannot be reversed unless sale is stayed pending appeal. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

[18] Bankruptcy

Effect of want of stay; c onclusiveness of sale

Bankruptcy court did not clearly err in finding that successful bidder at auction of substantially all of Chapter 11 debtor limited liability company's (LLC) assets outside the ordinary course of business was a good faith purchaser, for purposes of Bankruptcy Code section providing that sale to good faith purchaser which is approved by bankruptcy court is final and cannot be reversed unless sale is stayed pending appeal; there was no evidence of fraud or collusion, rather, sale was conducted in a fair and open process. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

[19] Bankruptcy

Order of court and proceedings therefor in general

Bankruptcy

Effect of want of stay; c onclusiveness of sale

Bankruptcy court applied appropriate level of heightened scrutiny to sale of substantially all of Chapter 11 debtor limited liability company's (LLC) assets outside the ordinary course of business, for purposes of Bankruptcy Code section providing that sale to good faith purchaser which is approved by bankruptcy court is final and cannot be reversed unless sale is stayed pending appeal; bankruptcy court acknowledged that it needed to apply a heightened level of scrutiny to the sale because the sale was to occur outside a confirmed plan of reorganization, and because it involved a sale to an insider, it then did so before it approved the sale, and bankruptcy court thoroughly examined the relationship between debtor and successful purchaser and, at the requests of the United States Trustee and unsuccessful bidder, approved the appointment of examiner, who was tasked with monitoring the sale process. 11 U.S.C.A. § 363(m).

Cases that cite this headnote

***502 Appeal from the United States Bankruptcy Court for the District of New Hampshire, (Hon. J. Michael Deasy, U.S. Bankruptcy Judge)**

Attorneys and Law Firms

Robert J. Keach, Esq., and Michael A. Siedband, Esq., on brief for Appellant.

Daniel W. Sklar, Esq., and Christopher Desiderio, Esq., on brief for Appellee, Old Cold, LLC.

Christopher M. Candon, Esq., on brief for Appellee, Schleicher & Stebbins Hotels, L.L.C.

Before Lamoutte, Hoffman, and Cary, United States Bankruptcy Appellate Panel Judges.

Opinion

Lamoutte, U.S. Bankruptcy Appellate Panel Judge.

On December 18, 2015, the bankruptcy court entered an order (the "Sale Order") approving the sale of substantially all of the assets of the debtor, Old Cold, LLC, formerly known as Tempnology, LLC (the "Debtor"),[1] to Schleicher & Stebbins Hotels, L.L.C. ("S&S"). The bankruptcy court's approval of the sale was the culmination of a process that took place over the course of several months under the supervision of the bankruptcy court, and with input from the U.S. Trustee and an independent examiner, who was appointed to oversee the sale process because it involved a proposed insider transaction and a credit bid under § 363(k).[2] Mission Product ***503** Holdings, Inc. ("Mission"), an unsuccessful bidder for the Debtor's assets and a counterparty to one of the Debtor's rejected executory contracts, appealed the Sale Order, challenging the bankruptcy court's approval of the sale and its finding that S&S was a good faith purchaser.

For the reasons set forth below, we **AFFIRM**.

BACKGROUND

I. The Parties

Prior to the sale, the Debtor was a Portsmouth, New Hampshire based material innovation company that, among other things, developed chemical-free cooling fabrics under the Coolcore brand for use in consumer products. Kevin McCarthy ("McCarthy") was the Debtor's chief executive officer and Richard Ferdinand ("Ferdinand") was its chief financial officer.

S&S was the Debtor's majority equity owner, largest unsecured creditor, post-petition debtor-in-possession financier, stalking horse bidder, and successful purchaser. S&S originally invested in Frigid Fabrics LLC that, in turn, invested in and was a member of the Debtor. Thus, S&S had an indirect ownership interest in the Debtor. The principals of S&S, Mark Schleicher ("Schleicher") and Mark Stebbins ("Stebbins"), were, until July 2015, members of the Debtor's management committee.

Mission was the counterparty to a Co-Marketing and Distribution Agreement (the "Mission Agreement") that the Debtor subsequently rejected, and the only other qualified bidder for the Debtor's assets.

II. Pre-Bankruptcy Events

The Debtor was formed in 2011. In 2012, the Debtor and Mission executed the Mission Agreement, whereby the Debtor granted Mission exclusive distribution rights to certain of the Debtor's products within the United States. The Mission Agreement also gave Mission a nonexclusive, irrevocable, royalty-free, perpetual, worldwide, fully-transferrable license to, among other things, freely exploit certain of the Debtor's intellectual property.

Despite some level of sales, the Debtor remained unprofitable and plagued with losses. To combat its liquidity problems, the Debtor sought financing. In the spring of 2013, the Debtor obtained a secured line of credit from People's United Bank (the "LOC") with a credit limit of approximately $350,000.

The Debtor also borrowed money from S&S. It executed in favor of S&S a Commercial Term Note dated August 15, 2013, in the original principal amount of up to $6,000,000, as amended by a First Allonge to Commercial Term Note dated March 25, 2015 ("Term Note"). S&S loaned millions of dollars to the Debtor under the Term Note on an unsecured basis, but at some point it concluded it could no longer remain an unsecured lender.

In the spring of 2014, S&S acquired the LOC, along with People's United Bank's first position security interest in the Debtor's assets and the loan documents under which it could make loans to the Debtor on a secured basis. S&S then increased the LOC loan limit from $350,000 to $4,000,000, and rolled some of its unsecured debt into the secured LOC.

The Debtor's relationship with Mission also deteriorated in 2014, with both parties asserting material breaches of the Mission Agreement. After both parties attempted to terminate the Mission Agreement, they submitted the matter for a two-phase arbitration. On June 5, 2015, the arbitrator ***504** issued a Partial Final Award, determining the Debtor's termination for cause was ineffective and that the Mission Agreement remained in full force and effect during a two-year, wind down period. The remainder of the arbitration was stayed by the Debtor's bankruptcy.

In March 2015, the Debtor's management committee accepted a proposal by S&S to convert a portion of S&S' remaining unsecured debt to equity interests in the Debtor.[3] As a result of this conversion of debt to equity, as well as S&S' existing indirect ownership interest in the Debtor through Frigid Fabrics LLC, S&S became the majority owner of the Debtor.

By July 2015, the Debtor's financial situation had not improved, and it became apparent that a workout between S&S and the Debtor would be necessary. On July 13, 2015, the Debtor's management committee met with Stebbins to discuss the Debtor's financial status and the possible terms of a forbearance agreement for S&S' secured loans. Two days later, both Stebbins and Schleicher resigned from the Debtor's management committee, and were replaced by McCarthy and Ferdinand.

On July 16, 2015, S&S issued the Debtor a notice of default for failure to make payments on the LOC. Thereafter, S&S and the Debtor negotiated the terms of a forbearance agreement, which provided for an additional $1,400,000 in secured financing through September 1, 2015, on the condition that the Debtor file for bankruptcy and seek to sell substantially all of its assets pursuant to § 363.

In the meantime, in July 2015, the Debtor, without any involvement from anyone at S&S, engaged Phoenix Capital Resources ("Phoenix") as its investment banker to assess the Debtor's options, with Vincent Colistra ("Colistra") of Phoenix serving as lead investment banker. Colistra, determining that a sale of the Debtor's assets was necessary, developed a sales and marketing strategy for the Debtor's business. In August 2015, Phoenix, without direction from the Debtor, contacted S&S to commence sale negotiations after five other potential buyers declined to do so. Neither McCarthy nor Ferdinand was involved in the sale negotiations with S&S, relying instead on counsel from Nixon Peabody LLP to negotiate the agreement on the Debtor's behalf. S&S' counsel, Christopher Candon, negotiated on S&S' behalf.

In the original Asset Purchase Agreement dated September 1, 2015, S&S bid $6,950,000, the vast majority of which would be paid by a credit bid in the amount of S&S' secured loan. Ferdinand testified that the original Asset Purchase Agreement embodied terms that were initially discussed at the July 13, 2015 meeting between S&S and the Debtor. All witnesses testified, however, it was Phoenix that approached S&S regarding the possibility of S&S entering into an agreement to purchase the Debtor's assets in a bankruptcy sale, thereby assuming the role of "stalking

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horse," and that the sale negotiations were completed by counsel.

All witnesses testified they expected the ultimate purchaser would be S&S, but understood the sale would be to the highest bidder and subject to bankruptcy court approval in accordance with § 363. Stebbins testified he wanted the proposed sale to take place as quickly as possible, but deferred to Phoenix regarding how much marketing was needed. He also testified S&S pursued this transaction because he and Schleicher always believed in the ***505** Debtor and its product, but felt a restructuring of the Debtor's obligations—especially the Mission Agreement —was necessary before S&S could become involved.

III. The Bankruptcy Case

A. Procedural History

On September 1, 2015, the Debtor filed a chapter 11 petition. On Schedule D-Creditors Holding Secured Claims, the Debtor listed S&S as holding a secured claim in the amount of $5,550,000 for loans made between August 28, 2014, and August 24, 2015. The Debtor also filed a motion seeking authority to obtain post-petition debtor-in-possession financing from S&S and to use S&S' cash collateral ("DIP Motion").

On September 2, 2015, the Debtor filed a motion seeking, among other things, an order approving procedures in connection with, and authorizing the sale of, substantially all of the Debtor's assets free and clear of liens, claims, encumbrances, and other interests (the "Sale Motion"), and a motion to reject certain executory contracts, including the Mission Agreement (the "Rejection Motion"). By the Sale Motion, the Debtor proposed to sell substantially all of its assets to S&S in accordance with the Asset Purchase Agreement, subject to an approved sale process and higher and better bids that would be solicited through the sale process and auction. The proposed purchase price under the Asset Purchase Agreement was $6,950,000, consisting of S&S' credit bid of $6,850,000, plus $100,000 of the Debtor's liabilities to be assumed by S&S.

On September 4, 2015, the bankruptcy court issued an order granting the DIP Motion on an interim basis, authorizing the Debtor to obtain post-petition financing from S&S up to an aggregate of $500,000 (the "DIP Facility").[4] On September 9, 2015, S&S advanced $250,000 to the Debtor under the DIP Facility. On September 24, 2015, the bankruptcy court entered a second order approving the DIP Facility on an interim basis.

On September 11, 2015, Mission filed an objection to the Rejection Motion, the Sale Motion, and the DIP Motion, in which it indicated it was electing to retain rights under the Mission Agreement pursuant to § 365(n). Mission argued, among other things, that the bankruptcy court should deny the Sale Motion and DIP Motion to the extent they requested authority for S&S to credit bid its claims, arguing there had been no determination as to the validity or extent of S&S' security interest. It also argued that the Sale Motion impermissibly sought to use § 363 to sell the Debtor's assets free and clear of Mission's rights as reserved pursuant to its election under § 365(n), and the sale process was "being driven by S&S," who was an insider of the Debtor, as well as the Debtor's major secured creditor and the proposed post-petition lender.

On September 14, 2015, the U.S. Trustee filed a motion seeking an order converting the case to chapter 7 or authorizing the appointment of a trustee or examiner as an independent fiduciary to undertake the administration, investigation, and/or liquidation of the Debtor's estate. The next day, Mission also filed a motion seeking the appointment of a trustee or examiner, arguing that such appointment would allow "for a thorough, independent, and expeditious examination to be made into serious allegations," and would "allow for the timely and costeffective ***506** investigation of those issues as well as any other misconduct by the Debtor and its insiders during and before the Petition Date."

On September 16, 2015, the U.S. Trustee filed an objection to the Sale Motion, in which he reasserted his position that cause existed for the appointment of an independent fiduciary to evaluate the proposed insider sale.

On September 18, 2015, the bankruptcy court entered an order directing the U.S. Trustee to appoint an examiner, and on September 24, 2015, the bankruptcy court approved the U.S. Trustee's request to appoint Michael Askenaizer as examiner (the "Examiner") to oversee the proposed sale process. The Examiner filed an interim report on September 30, 2015.

On October 2, 2015, the bankruptcy court held a hearing on several matters, including the Sale Motion and the Rejection Motion. At the hearing, S&S agreed to lower the proposed purchase price under the Asset Purchase Agreement to $1,050,000, credit bidding $750,000 in post-petition financing extended to the Debtor under the DIP Facility (the "DIP Financing"), and assuming approximately $300,000 in liabilities, consisting of approximately $130,000 in pre-petition accounts payable incurred within 60 days of the petition date and approximately $150,000 in cure costs related to certain contracts the Debtor wished to assume. Stebbins testified that S&S considered its agreement to lower its bid to be a concession in the hope of avoiding a fight over its credit bidding rights, but that S&S always intended to credit bid its pre-petition debt if necessary. Moreover, notwithstanding the amount of the DIP Financing embodied in the stalking horse bid, both Ferdinand and Stebbins testified S&S had only advanced $250,000 in DIP Financing as of the date of the bid.

On October 8, 2015, the bankruptcy court entered an order approving procedures in connection with the sale of the Debtor's assets, and approving S&S as the stalking horse bidder ("Sales Procedure Order"). It also allowed S&S to credit bid, providing:

> [S&S] is hereby granted the right to credit bid up to and including the post-petition amounts loaned to the Debtor under this Court's Post-Petition Financing and Cash Collateral Orders as of the Auction Date and ... to credit bid up to an additional $5,650,000 (the amount of [S&S]'s claim listed on the Debtor's Schedule D, plus accrued interest as of the Petition Date[ ]) on the Assets.

The bankruptcy court set a deadline of November 2, 2015, for any other bids, an auction date of November 5, 2015, if other bids were received, a deadline of November 12, 2015, for any party to object to the sale, and a hearing date of November 18, 2015, to consider the proposed sale. In a separate order, the bankruptcy court granted the Rejection Motion, permitting the Debtor to reject the Mission Agreement subject to Mission's election to preserve its rights under § 365(n). Mission did not appeal either order.

On October 9, 2015, the bankruptcy court entered a third order relating to the DIP Facility ("Third Interim DIP Order"), authorizing the Debtor "to obtain credit and incur debt ... up to the aggregate amount of $750,000 ..." from S&S. The order also provided as follows:

> Pursuant to Section 363(k) of the Bankruptcy Code, the Lender is hereby granted the right to credit bid up to and including the postpetition amounts loaned to the Debtor under the Interim Order and this Order as of the Auction Date and Lender reserves the right to credit bid up to an additional $5,650,000 (the amount of the Lender's claim listed ***507** on the Debtor's Schedule D, plus accrued interest as of the Petition Date) on the sale of substantially all of the Debtor's assets. Any challenge to the Lender's additional credit bid at the Auction must be raised on or before November 12, 2015 at 5:00 p.m.; provided, however, that the rights of any subsequently appointed Chapter 11 trustee, Chapter 7 Trustee or Examiner with expanded powers (if any is appointed), to examine, contest or recover payment of the secured prepetition claim being credit bid as the "additional credit bid" are preserved.

On October 29, 2015, one week before the scheduled auction, S&S advanced an additional $500,000 to the Debtor in DIP Financing, as authorized by the Third Interim DIP Order.

On November 2, 2015, Mission made a timely, qualified, all-cash bid of $1,300,000 to purchase the Debtor's assets.

On November 12, 2015, the Debtor filed a supplement to its DIP Motion, seeking to increase the total credit available under the DIP Facility from $1,300,000 to $1,450,000 to facilitate the closing of the sale. No party filed an opposition to the supplemental motion. On December 2, 2015, the bankruptcy court issued an order authorizing the Debtor "to obtain credit and incur debt ... up to the aggregate amount of

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$1,450,000 ...” upon certain terms and conditions set forth therein (the “Final DIP Order”).

B. Marketing Efforts for the Sale of the Debtor's Assets

Following the entry of the Sales Procedure Order, Phoenix continued its marketing efforts by sending teaser materials to 164 potential buyers, including liquidators, branding experts, apparel and textile companies, medical businesses, and hedge funds. Despite Phoenix's marketing efforts, other than S&S, only four parties signed nondisclosure agreements and gained access to the data room for the review of confidential information, and only Mission submitted a bid that was higher than S&S' stalking horse bid.

At the Sale Hearing, described herein, Colistra and McCarthy testified that, as part of this process, the Debtor provided Phoenix the names of businesses Phoenix should not contact in connection with the proposed sale. The list consisted of major existing or prospective customers even though Colistra testified major customers are often the most active bidders in sales pursuant to § 363. McCarthy maintained he did not want Phoenix to contact certain customers because the Debtor's size made it reliant on every order and he did not want to raise concerns about the Debtor's ability to fulfill orders. Notwithstanding the lack of direct marketing to customers, a press release regarding the sale was transmitted to all customers, distributors, and other “key international players.” Also at the Sale Hearing, Colistra testified Phoenix followed its normal sales and marketing process and, given Colistra's experience with sales both in and out of bankruptcy, he opined that an additional 60 days of marketing and due diligence would not have yielded a different result in light of the responses Phoenix received.

C. The Auction

On November 5, 2015, the Debtor conducted the auction (the “Auction”) at the offices of its counsel, Nixon Peabody LLP. The Debtor and its professionals (counsel and investment banker), the Examiner and his counsel, a representative of the U.S. Trustee, Mission and its counsel, and S&S and its counsel attended the Auction. Only S&S and Mission participated as bidders at the Auction.

***508** At the outset of the Auction, the Debtor's counsel announced the general framework of the Auction procedures and informed parties that “[n]egotiations may be conducted off the record.” No party objected to the procedures outlined by the Debtor's counsel. The Debtor made the following representations regarding the state of its assets and liabilities: (1) S&S had loaned the Debtor $750,000 under the DIP Facility; (2) the Debtor was holding cash in the amount of $600,000; (3) the Debtor had accounts receivable in the amount of $100,000; (4) the Debtor had inventory of $1,200,000 at cost consisting almost entirely of finished product with a sales margin of at least 20%; (5) the Debtor had postpetition accounts payable of approximately $350,000; and (6) the “carve-out” for the Debtor's professionals under the DIP Facility totaled $400,000. Notably, under the asset purchase agreements signed by S&S and Mission, the Debtor's cash and cash equivalents were included as acquired assets.

In light of Mission's qualified bid of $1,300,000 in cash, S&S opened bidding with a bid of $1,400,000, which included a pre-petition credit bid. The Debtor immediately indicated it was accepting S&S' bid as superior to Mission's $1,300,000 cash bid. Mission, protesting S&S' credit bid of pre-petition debt and reserving the right to return to its original bid, increased its offer to $1,500,000, consisting of its original cash bid of $1,300,000, plus $200,000 of the Debtor's cash and cash equivalents to be excluded from the acquired assets and left in the estate.

As bidding continued, the Debtor, in response to Mission's bidding with respect to the Debtor's assets (i.e. agreeing to exclude certain assets from the assets to be acquired and leave them in the estate), including its accounts receivable and inventory, announced that for purposes of the Auction the value of the accounts receivable would be reduced from $100,000 to $80,000, and the value of the inventory would be reduced from $1,200,000 to a liquidation value of $120,000. Colistra testified this was done when he realized it was not appropriate to utilize “book value” in this context for these assets. Mission did not object to these valuations and both Mission and S&S used them in subsequent bids.

After several more rounds of bidding, Mission submitted its final bid, which totaled $2,600,000 (the “Mission Final Bid”), consisting of the following:

(1) $1,800,000 in cash paid by Mission;

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(2) $600,000 of the Debtor's cash to be excluded fromacquired assets and left in the estate;

(3) $80,000 of the Debtor's accounts receivable to beexcluded from acquired assets and left in the estate; and

(4) $120,000 of the Debtor's inventory to be excludedfrom acquired assets and left in the estate.

The Debtor accepted the Mission Final Bid as being higher than the previous S&S bid.

Following the Mission Final Bid, S&S made its final bid totaling $2,700,000 (the “S&S Final Bid”) consisting of the following:

(1) $750,000 credit bid of DIP Financing;

(2) $657,000 pre-petition unsecured debt which S&Swould assume in the amounts scheduled by the Debtor, excluding disputed claims and any rejection damage claims, but reserving the right to attempt to negotiate settlements with each creditor;

(3) $600,000 of the Debtor's cash to be excluded fromacquired assets and left in the estate;

***509** (4) $80,000 of the Debtor's accounts receivable to be excluded from acquired assets and left in the estate;

(5) $120,000 of the Debtor's inventory to be excludedfrom acquired assets and left in the estate;

(6) $50,000 of post-petition accounts payable which S&S would assume; and

(7) $443,000 credit bid of pre-petition debt.

Stebbins testified that in making the S&S Final Bid, S&S altered its bidding strategy in two ways. First, it mirrored Mission's bid structure to make it easier to compare the two bids and second, it reduced the amount of its credit bid of pre-petition debt to avoid a further challenge by Mission.

The Debtor accepted the S&S Final Bid. Mission declined to be designated as the backup bidder, protesting that the Mission Final Bid was in fact higher and better than the S&S Final Bid. Thereafter, on November 6, 2015, the Debtor filed a notice in the bankruptcy court that it had accepted the S&S Final Bid.

D. Post-Auction Procedural History On November 12, 2015, Mission filed the following objections to the proposed sale to S&S (collectively, the “Objections”): (1) Mission Product Holdings, Inc.'s Challenge to Credit Bid of Pre-Petition Credit of Schleicher & Stebbins Hotels, LLC; and (2) Mission Product Holdings, Inc.'s Objection to Conduct of Auction and Sale, as amended. In the Objections, Mission argued, among other things, that: (1) the S&S Final Bid was inferior to the Mission Final Bid; (2) the court should deny S&S' credit bidding rights and recharacterize S&S' claim as equity; (3) the Auction was conducted in bad faith; and (4) the sale should be denied as a sub rosa plan. On November 16, 2015, the Examiner, the Debtor, and S&S each filed responses to the Objections.

The Examiner filed his final report on November 13, 2015, which he subsequently amended with leave of the bankruptcy court on November 24, 2015 (the “Final Report”). In the Final Report, the Examiner concluded, after conducting his own valuation of the bids, that the S&S Final Bid was superior to the Mission Final Bid. He also concluded that Mission and all other creditors would receive better treatment through the proposed sale to S&S than through the only realistic alternative —liquidation. The Examiner reasoned that in light of S&S' secured claim in the amount of $5,500,000, which he determined was not subject to a viable claim for equitable subordination and only $2,000,000 of which might be vulnerable to a recharacterization challenge, the Debtor's creditors would not receive any distribution under any other circumstances. The Examiner further opined that given the limited value of the Debtor's business and the fact that the only parties bidding on the assets were the parties already involved with the Debtor, the marketing efforts by the Debtor and its professionals were adequate and further marketing efforts would not yield a more favorable result.

In his response to the Objections, the Examiner stated, among other things, that he disagreed with Mission's assertion that S&S and the Debtor had “colluded” or that S&S had not acted in good faith in connection with the Auction. He stated as follows:

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> The Examiner is unconvinced that the cooperation between the Debtor and S&S is collusion[.] Nor is the Examiner convinced that the allegations of Mr. Stebbins' control of the debtor converts reasonable business cooperation into some evil called by Mission "collusion" but which is really a claim of conspiracy.
>
> ***510** If by "collusion" Mission means "conspiracy" then the allegations by Mission do not set out such a claim. To make out a claim of conspiracy there must be an agreement to accomplish an unlawful end or to accomplish some lawful end by unlawful means: "A civil conspiracy is a combination of two or more persons by concerted action to accomplish an unlawful purpose, or to accomplish some purpose not in itself unlawful by unlawful means." Jay Edwards, Inc. Baker, 130 N.H. 41, 47, 534 A.2d 706, 709 (1987) (quotations omitted); See, e.g., 18 U.S.C. § 371 ("If two or more persons conspire to commit any offense ... and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined or imprisoned ...").
>
> The Examiner has seen neither unlawful means used nor an unlawful end, and so concludes that there is no conspiracy and therefore no collusion in any nefarious sense.
>
> Even if there were collusion (which the Examiner does not believe exists) it is not a ground to deny approval of the sale, but is only relevant, at best to issues under Section 363(m) if Mission prevails on appeal.

On November 18, 2015, and November 23, 2015, the bankruptcy court conducted an evidentiary hearing to consider the proposed sale and the Objections (the "Sale Hearing"), at which Colistra, McCarthy, Ferdinand, and Stebbins testified. The bankruptcy court admitted eighteen exhibits into evidence. At the conclusion of the Sale Hearing, the bankruptcy court took the matter under advisement and directed the parties to file proposed orders by December 1, 2015. Mission, the Debtor, and S&S all filed supplemental pleadings with proposed orders. Attached to the Debtor's proposed order were revised copies of the Asset Purchase Agreement with S&S.

On December 15, 2015, the Debtor filed a Status Report informing the bankruptcy court that the Debtor anticipated its cash balance as of December 18, 2015, would be approximately $60,000, and if it did not close the sale on or before December 18, 2015, it would need to draw an additional $150,000 in DIP Financing in order to have sufficient funds to operate through December 31, 2015.

E. The Bankruptcy Court's Order and Opinion.

On December 18, 2015, the bankruptcy court entered the Sale Order. In its accompanying decision, the bankruptcy court made thorough and detailed factual findings and conclusions based on the record, the evidence presented at the Sale Hearing, and the conclusions of the Examiner. See In re Tempnology, LLC, 542 B.R. 50 (Bankr. D.N.H. 2015). Noting the need for heightened scrutiny because the sale would take place outside of a confirmed plan of reorganization and because the proposed purchaser, S&S, was an insider, the bankruptcy court determined: (1) there was a valid business reason for a sale prior to a confirmed plan of reorganization, and the proposed sale to S&S made good sense in the overall context of the reorganization as there was no alternative that would yield a benefit to creditors; (2) the marketing of the Debtor's assets was sufficient and appropriate; (3) there was "no evidence in the record establishing any misconduct or collusion in the sale process by the Debtor and S&S"; (4) Mission's assertions that the Debtor's constant inflation of the value of S&S' bids evidenced collusion and misconduct were refuted by "simple math"; (5) Mission failed to demonstrate a compelling reason why S&S' credit bidding rights under § 363(k) should be limited; (6) the record did not support Mission's assertion that the Debtor was substantially controlled ***511** by Stebbins; (7) the proposed sale was not a de facto plan and creditors "were afforded protections consistent with the statutory safeguards attendant to the Chapter 11 confirmation process"; (8) there was "no evidence of fraud, collusion, or any other tainting of the sale process," and Mission failed to demonstrate the proposed sale was anything other than an arm's length transaction; and (9) S&S was a good faith purchaser and entitled to the protections afforded by § 363(m).

Specifically as to the finding that S&S was a good faith purchaser, the bankruptcy court stated as follows:

> Based on the findings outlined above, the Court concludes that S&S purchased for value. Despite the repeated invective, Mission has failed to demonstrate that the proposed sale is anything other than an arm's length transaction. There is no evidence of

> fraud, collusion, or any other tainting of the sale process in the record. To the contrary, the witness testimony reflects that Stebbins and S&S essentially divorced themselves from the Debtor when it became clear that a reorganization was needed. McCarthy and
> Ferdinand both testified that neither Stebbins nor S&S had any role [in] the Debtor's operations or marketing efforts once Stebbins and Schleicher resigned from the management committee. Colistra, the professional responsible for the Debtor's marketing strategy, testified that Phoenix had no contact with S&S other than to commence stalking horse negotiations when no other could be found. Even if the initial sale proposal pre-dated the involvement of independent counsel, Stebbins, McCarthy, and Ferdinand each credibly testified that no agreement was reached until the details were negotiated by counsel. Notably, the entire sale process was overseen by the Examiner and the United States Trustee, and neither have voiced any concerns or objections. Therefore, the Court finds that S&S is a good faith purchaser entitled to the protection of 11 U.S.C. § 363(m).

Thus, the bankruptcy court overruled Mission's Objections and approved the sale to S&S. In the Sale Order, the bankruptcy court ordered the stay imposed by Bankruptcy Rule 6004(h) and 6006(d) was waived, the order would be immediately effective upon entry, and the Debtor was authorized and directed to consummate the sale.

Mission did not seek to alter or amend the Sale Order or to have the sale stayed, and on December 21, 2015, the Debtor filed a Notice of Closing in which it informed the bankruptcy court that, as of 6:00 p.m. on December 18, 2015, the Debtor had closed the transaction with S&S as contemplated by the Sale Order. On December 28, 2015, ten days after the entry of the Sale Order, Mission filed its notice of appeal.

JURISDICTION

I. Finality

[1] We have jurisdiction to hear appeals from final judgments, orders and decrees of the bankruptcy court. See 28 U.S.C. § 158(a)(1). In the bankruptcy context, an order is "final" if it completely resolves "all the issues pertaining to a discrete dispute within the larger proceeding." Morse v. Rudler (In re Rudler), 576 F.3d 37, 43 (1st Cir. 2009) (quoting Perry v. First Citizens Fed. Credit Union (In re Perry), 391 F.3d 282, 285 (1st Cir. 2004)). Because the Sale Order effectively resolved all issues between the parties relating to the sale of the Debtor's assets, it is final. Our jurisdiction, however, does not rest on finality alone. Mootness will deprive us of jurisdiction to review a final order. See ***512** Richmond v. Sovereign Bank (In re Formatech, Inc.), No. MW 12-013, 2013 WL 87406, at *1 (1st Cir. BAP Jan. 8, 2013) (citation omitted).

II. Mootness

[2] Mootness is also a threshold jurisdictional issue. See GE Capital Franchise Fin. Corp. v. Richardson (In re Newport Creamery, Inc.), 295 B.R. 408, 417 (1st Cir. BAP 2003) (citations omitted). The Appellees argue this appeal should be dismissed as it is: (1) statutorily moot pursuant to § 363(m) because Mission failed to obtain a stay pending appeal; and (2) equitably moot because Mission failed to obtain a stay pending appeal, the sale of assets to S&S is complete, and the Panel is unable to fashion a remedy.

A. Statutory Mootness

Section 363(m) provides:

> The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

11 U.S.C. § 363(m).

[3] "The effect of § 363(m) is that 'when an order confirming a sale to a good faith purchaser is entered and a stay of that sale is not obtained, the sale becomes final and cannot be reversed on appeal.' " Anheuser–Busch, Inc. v. Miller (In re Stadium Mgmt. Corp.), 895 F.2d 845, 847 (1st Cir. 1990) (quoting Creditors Comm. v. Armstrong Bus. Credit Corp. (In re Saco Local Dev. Corp.), 19 B.R. 119, 121 (1st Cir. BAP 1982)). Without a stay of the sale, the court usually has no power to fashion a remedy because it cannot undo the sale, even if it were to find the authorization was erroneous. Id. (citations omitted); see also Mark Bell Furniture Warehouse, Inc. v. D.M. Reid Assocs. (In re Mark Bell Furniture Warehouse, Inc.), 992 F.2d 7, 8 (1st Cir. 1993); Kasparian v. Conley (In re Conley), 369 B.R. 67, 71 (1st Cir. BAP 2007).

> "Appellate courts have interpreted this section to prevent the overturning of a completed sale to a bona fide third party purchaser in the absence of a stay. ... This rule protects the finality of bankruptcy sales and the reasonable expectations of third party purchasers. ... [and] [i]t also reflects the inability of courts to supply a remedy once property has left the bankruptcy estate." Wintz v. American Freightways, Inc. (In re Wintz Cos.), 219 F.3d 807, 811 (8th Cir. 2000) (internal citations omitted); see Licensing by Paolo v. Sinatra (In re Gucci), 105 F.3d 837, 840 (2d Cir. 1997) (noting that "regardless of the merit of an appellant's challenge to a sale order, we may neither reverse nor modify the judicially-authorized sale if the entity that purchased or leased the property did so in good faith and if no stay was granted"); see also Oakville Dev. Corp. v. Fed. Deposit Ins. Corp., 986 F.2d 611, 614 (1st Cir. 1993) (holding that failure to obtain a stay pending appeal of district court's refusal to reinstate injunction before a foreclosure sale renders the appeal moot).

Green v. Gray, Nos. 12–10604–DJC and 12–10835–DJC, 2013 WL 1124731, at *5 (D. Mass. Mar. 18, 2013).

[4] Thus, it is well settled in the First Circuit that under § 363(m), a sale to a purchaser acting in good faith may not be reversed on appeal unless the aggrieved party obtains a stay of the sale. Canzano v. Ragosa (In re Colarusso), 382 F.3d 51, 61–62 (1st Cir. 2004) (citing ***513** In re Stadium Mgmt. Corp., 895 F.2d at 847). As a result, in the absence of a stay, the court must dismiss a pending appeal as moot. There is, however, an exception to this general rule. The First Circuit has stated that a stay is not required to challenge a sale on the ground that § 363(m) does not apply because the purchaser did not act in good faith. In re Colarusso, 382 F.3d at 61 n.10 (citing In re Sax, 796 F.2d 994, 997 n.4 (7th Cir. 1986)); see also Video Concepts, LLC v. Volpe Indus., Inc. (In re Volpe Indus., Inc.), No. 13–10300–DPW, 2013 WL 4517983, at *3 (D. Mass. Aug. 23, 2013).

[5] Mission did not seek or obtain a stay of the Sale Order pending this appeal. It did, however, object to the proposed sale to S&S on the ground that S&S, who was an insider of the Debtor, was not and could not be a good faith purchaser, and Mission included among its issues on appeal the question of whether the bankruptcy court erred in finding S&S was a good faith purchaser for value. Thus, the failure to obtain a stay is not fatal to Mission's appeal.

But, in the absence of a stay, § 363(m) operates to limit appellate review of a sale order to the specific question of whether the purchaser was a good faith purchaser. See In re Gucci, 105 F.3d at 839 (holding "appellate jurisdiction over an unstayed sale order issued by a bankruptcy court is statutorily limited to the narrow issue of whether the property was sold to a good faith purchaser") (emphasis omitted); Cent. Me. Healthcare Corp. v. Parkview Adventist Med. Ctr., No. 2:15–cv–00527–JDL, 2016 U.S. Dist. LEXIS 48676, at *8–9 (D. Me. Apr. 11, 2016) (noting "because there was no stay order ... § 363(m) operates to limit appellate review of the Sale Order to the specific question of whether [the purchaser] was a good faith purchaser."); Dick's Clothing & Sporting Goods, Inc. v. Phar–Mor, Inc., 212 B.R. 283, 290 (N.D. Ohio 1997) (ruling because appellant was unsuccessful at obtaining a stay, all of the issues raised in the appeal were moot except for the issue of good faith).

Therefore, although Mission failed to obtain a stay, its appeal is not statutorily moot to the extent it challenges the good faith status of S&S. The appeal is limited, however, to the issue of good faith.

B. Equitable Mootness

[6] [7] The doctrine of equitable mootness allows an appellate court to dismiss a bankruptcy appeal if " 'an unwarranted or repeated failure to request a stay enabled developments to evolve in reliance on the bankruptcy court

order to the degree that their remediation has become impracticable or impossible,' " or if " 'the challenged bankruptcy court order has been implemented to the degree that meaningful appellate relief is no longer practicable even though the appellant may have sought a stay with all due diligence.' " Prudential Ins. Co. of Am. v. SW Boston Hotel Venture, LLC (In re SW Boston Hotel Venture, LLC), 748 F.3d 393, 402 (1st Cir. 2014) (quoting Hicks, Muse & Co. v. Brandt (In re Healthco Int'l, Inc.), 136 F.3d 45, 48 (1st Cir. 1998)); see also In re Conley, 369 B.R. at 71–72. Although the issue of equitable mootness in bankruptcy appeals arises most frequently in cases involving confirmation orders, courts have also applied the doctrine to bankruptcy appeals involving other orders, including orders authorizing sales under § 363.[5] See,

***514** e.g., Braemer v. Lowey, No. 08–cv–348–P–S, 2009 WL 465972 (D. Me. Feb. 24, 2009) (dismissing appeal of sale order as equitably moot); Bonnett v. Gillespie (In re Irish Pub Arrowhead Land, LLC), BAP No. AZ– 13–1024–PaKuD, 2014 WL 486955, at *5 (9th Cir. BAP Feb. 6, 2014) ("To be sure, equitable mootness applies to appeals of orders concerning sales under § 363.") (citation omitted). The party arguing for dismissal bears the burden of establishing equitable mootness. See Braemer v. Lowey, 2009 WL 465972, at *1. Although failure to seek a stay weighs in favor of finding mootness, it is insufficient on its own to render the appeal equitably moot. "The court must consider pragmatic considerations, specifically, whether granting appellate relief would adversely affect third parties regardless of whether the appellant sought a stay, ... or is impracticable because of the extent to which the order has been implemented." ROK Builders, LLC v. 2010–1 SFG Venture, LLC, No. 13–cv–16–PB, 2013 WL 3762678, at *6 (D.N.H. July 16, 2013) (citations omitted).

[8] The Appellees argue that this appeal is equitably moot because Mission did not diligently seek a stay pending appeal, and the relief requested would be complex and difficult for the Panel to provide as the sale has closed. According to the Appellees, the Debtor, S&S, and the creditors whose debts S&S assumed have relied on the finality of the Sale Order. Specifically, they contend S&S has: (1) made substantial payments to, or reached agreements with, the Debtor's pre- and post-petition creditors whose claims S&S assumed; (2) purchased $250,000 of the Debtor's inventory and committed to buy the remainder at cost on or before September 30, 2016; (3) hired all of the Debtor's former employees; and (4) started marketing and selling products to customers. They also contend the Debtor has started to liquidate its limited remaining assets and retained a chief liquidation officer to do so. Thus, they argue, appellate relief would adversely affect third parties and it would be impracticable for the Panel to fashion any effective relief.

Mission counters, contending that although the sale has closed, there has been no third party reliance and there is no third party that will suffer from reversal because the sale itself was no more than a change in entity —the Debtor's business has the same location, same name, same employees, same management structure, same assets, same debts, and same controlling owner (S&S) as before the sale. According to Mission, the Debtor's business was largely unaffected by the sale and the Panel has ample authority to fashion a remedy.

As noted above, the Appellees have the burden of establishing the appeal is equitably moot. Although they press their arguments vigorously, the Appellees have not carried that burden. We are not convinced the transactions which have occurred since the closing of the sale are incapable of being unwound. Thus, we conclude this appeal is not equitably moot.

STANDARD OF REVIEW

[9] [10] [11] [12] [13] We review a bankruptcy court's findings of fact for clear error and its conclusion of law de novo. See ***515** Jeffrey P. White & Assocs., P.C. v. Fessenden (In re Wheaton), 547 B.R. 490, 496 (1st Cir. BAP 2016) (citation omitted). As discussed above, § 363(m) prohibits us from disturbing a sale on appeal that was not stayed if the buyer purchased the property in good faith. See 11 U.S.C. § 363(m). Good faith is a mixed question of law and fact. In re Mark Bell Furniture Warehouse, 992 F.2d at 8 (citation omitted); In re Cable One CATV, 169 B.R. 488, 492 (Bankr. D.N.H. 1994) (citation omitted); cf. Green v. Gray, 2013 WL 1124731, at *4 (applying clearly erroneous standard to bankruptcy court's determination buyer was good faith purchaser). "[A] mixed question of law and fact [is] subject to the clearly erroneous standard, unless the bankruptcy court's analysis was 'infected by legal error.' " Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries, Inc., 50 F.3d 72, 73 (1st Cir. 1995) (citing Williams v. Poulos, 11 F.3d 271, 278 (1st Cir. 1993)).

"The bankruptcy court findings will be considered clearly erroneous if, after a review of the entire record, we are left with the definite and firm conviction that a mistake has been committed." Bezanson v. Thomas (In re R & R Assocs. of Hampton), 402 F.3d 257, 264 (1st Cir. 2005) (citation omitted) (internal quotations omitted). "If two views of the evidence are possible, the trial judge's choice between them cannot be clearly erroneous." Nickless v. Catton (In re Catton), 542 B.R. 33, 36 (D. Mass. 2015) (citing Williams v. Poulos, 11 F.3d at 278).

Because Mission did not obtain a stay, the only issue before us is whether the bankruptcy court clearly erred in finding S&S was a good faith purchaser.

DISCUSSION

[14] [15] [16] Although the Bankruptcy Code does not define the term "good faith purchaser," the First Circuit has held that a good faith purchaser is one who purchases property (1) in good faith; (2) for value; and (3) without knowledge of adverse claims. See In re Mark Bell Furniture Warehouse, 992 F.2d at 8; Oakville Dev. Corp., 986 F.2d at 614; Greylock Glen Corp. v. Cmty. Sav. Bank, 656 F.2d 1, 4 (1st Cir. 1981). The "good faith" of a buyer concerns the integrity of the buyer's conduct during the sales process. In re Cable One CATV, 169 B.R. at 493 (citations omitted). "Typically, the misconduct that would destroy a purchaser's good faith status ... involves fraud, collusion between the purchaser and other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders." Id. (citations omitted) (internal quotations omitted). Mere allegations of collusion, without convincing direct evidence, are insufficient to establish lack of good faith. See, e.g., id. at 493–94 (finding good faith satisfied, "despite endless accusations of secret deals and collusion," where "the debtor has failed to introduce any direct evidence of unfair dealings, under-the-table negotiations, or selective information dissemination between [the buyer] and the trustee to substantiate allegations of collusion").

Mission contends the bankruptcy court erred in finding S&S was a good faith purchaser because: (1) S&S was an interested insider and the evidence presented at the Sale Hearing, as well as the post-sale conduct of the Debtor and S&S, are direct evidence of collusion between them; and (2) the bankruptcy court erroneously applied the common business judgment standard rather than the heightened scrutiny standard when considering the proposed sale to an insider. We disagree. Nothing in the record persuades us that the bankruptcy court's good faith finding was clearly erroneous. We also conclude that the bankruptcy court applied the correct legal standard.

***516 I. Insider Status and Allegations of Collusion**

[17] It is well established that a party's status as an insider does not automatically prevent it from being a purchaser in good faith. See In re Family Christian, LLC, 533 B.R. 600, 627 (Bankr. W.D. Mich. 2015) ("[N]othing within the Bankruptcy Code prohibits insiders from purchasing estate assets.") (citations omitted). Although the sale of property to an insider is subject to careful scrutiny, see In re Tidal Constr. Co., 446 B.R. 620, 624 (Bankr. S.D. Ga. 2009) ("[Section] 363 sales to insiders are subject to higher scrutiny because of the opportunity for abuse"), it is not per se bad faith for an insider to purchase the assets of the debtor. See Coleman v. ANMP (In re Dexter Distrib. Corp.), 434 Fed.Appx. 618, 619 (9th Cir. 2011) (citation omitted); Hower v. Molding Sys. Eng'g Corp., 445 F.3d 935, 939 (7th Cir. 2006); U.S. Small Business Admin. v. Xact Telesolutions, Inc. (In re Xact Telesolutions, Inc.), No. DKC 2005–1230, 2006 WL 66665, at *6 (D. Md. Jan. 10, 2006) ("[T]he majority of courts have held that a sale of assets to a fiduciary or insider is not bad faith per se.") (citations omitted). Thus, a sale to an insider, without more, does not establish a lack of good faith.[6]

[18] Mission, arguing there was clear evidence at the Sale Hearing of collusive conduct between the Debtor and S&S which establishes S&S was not a good faith purchaser, points to the following:

1. S&S tendered a loan forbearance agreement tothe Debtor which contained a requirement that the Debtor file bankruptcy and conduct a § 363 sale, which agreement the Debtor, controlled by S&S/Stebbins' appointees, did not negotiate in any way;

2. the Debtor's management, selected by the principalsof S&S, expressly limited marketing of the Debtor's assets, by banning contact with the customers most likely to buy the assets;

3. the Debtor made no effort to challenge the credit bidrights of S&S despite the testimony of the Debtor's own investment banker that such a credit bid would, and did, chill the sale and discourage bidding;

4. the Debtor and S&S colluded in having the Debtoraccept as a qualifying bid S&S' credit bid which included loan proceeds that had not been advanced, even though the Debtor's own investment banker testified that a credit bid could not be made on unadvanced funds;

5. the Debtor and S&S colluded to have S&S advancemoney to the Debtor on the eve of the Auction in order to support an S&S credit bid, even though the Debtor did not need to borrow the money;

6. the Debtor consistently colluded with S&S to overvalue each S&S bid at Auction, by double-counting the value of cash to be excluded from acquired assets and left in the estate by S&S;

7. the Debtor and S&S failed to disclose at the Auctionand at the Sale Hearing that S&S would not allow the Debtor to ***517** sell the inventory S&S had excluded from acquired assets and left in the estate, rendering this component of the bid valueless;

8. the Debtor and S&S engaged in numerous off-therecord, private communications during the Auction regarding the structuring of the S&S bid;

9. the Debtor unilaterally changed the value of its assetsfor Auction purposes solely to benefit S&S;

10. the Debtor and S&S failed to disclose variouswaivers by S&S of terms and conditions of the S&S asset purchase agreement with respect to hiring of employees, executive contracts and assumption of debt; and

11. the Debtor's executives assumed at all times thatthey would run the business purchased by S&S and did not expect or plan for a third-party purchase.

These are the same allegations Mission raised before the bankruptcy court, and which the bankruptcy court found to be unsupported by the evidence. The bankruptcy court effectively addressed and rejected all of these claims, finding "no evidence of fraud, collusion, or any other tainting of the sale process in the record."

Mission's allegation that Stebbins' pre-petition involvement as a member of the Debtor's management committee is evidence of his control of the Debtor and collusion between S&S and the Debtor, is unsupported by the evidence. As the bankruptcy court pointed out, Stebbins testified, when it became apparent a workout between S&S and the Debtor would be necessary, both Stebbins and Schleicher resigned from the Debtor's management committee, the Debtor and S&S each retained independent counsel, and Stebbins took no further part in the Debtor's operations or Phoenix's marketing efforts. The bankruptcy court found Stebbins' testimony to be credible, and we give great deference to the bankruptcy court's factual findings when they are based on the credibility and demeanor of the witnesses. See Robin Singh Educ. Servs., Inc. v. McCarthy (In re McCarthy), 488 B.R. 814, 825 (1st Cir. BAP 2013) (citation omitted). Moreover, Stebbins' testimony was supported by that of McCarthy and Ferdinand, each of whom testified that neither Stebbins nor S&S had any involvement with the Debtor's operations or marketing efforts once Stebbins and Schleicher resigned from the management committee.

As to Mission's allegations that S&S, through Stebbins, dictated the terms of important transactions, such as the loan forbearance agreement and Asset Purchase Agreement, and the Debtor simply agreed to these without negotiation, the bankruptcy court found this was "not a proper characterization of the record." As the bankruptcy court observed, while the salient terms of the forbearance agreement and Asset Purchase Agreement may have been initially discussed at a meeting held in July 2015, before counsel became involved, Stebbins, McCarthy, and Ferdinand each testified that the details of those agreements were negotiated later by their respective counsel, and no agreement was reached until those details were negotiated. The bankruptcy court found this uncontroverted testimony to be credible, and we give the bankruptcy court's credibility finding great deference.

As to Mission's allegations that there were flaws in the sale process that rendered the Auction unfair, the bankruptcy court concluded there was no prejudice. The bankruptcy court noted that, although the credit bid component of S&S'

initial stalking horse bid exceeded the amount of loan proceeds actually advanced by S&S at the time the Debtor accepted it, by the date of the Auction, S&S had advanced the ***518** full amount of the DIP Financing. The bankruptcy court also rejected Mission's argument the Debtor engaged in inappropriate off-the-record bid negotiations with S&S. The bankruptcy court noted such communications were consistent with the bidding procedures announced at the beginning of the Auction and applied to all parties equally, and Mission failed to explain how these negotiations tainted the Auction. As to Mission's claim that the Debtor's mid-Auction revaluation of its inventory and accounts receivable was intended to devalue Mission's bids, the bankruptcy court found that the discount applied to both parties' bids, and, therefore, Mission remained on an equal footing with S&S and its objection was "ill-taken." The bankruptcy court also found "simple math" refuted Mission's assertions that collusion and misconduct were apparent by the Debtor's constant inflation of the value of S&S' bids.

On appeal, Mission presses its arguments that the bidding process was "deeply flawed" and S&S cannot be a good faith purchaser because the Debtor plainly accepted a bid from S&S when that bid included a credit bid component that was underfunded at the time it was made. Mission argues the bankruptcy court's determination that the underfunded bid was of no consequence because it was fully funded prior to the Auction is flawed. According to Mission, both parties knew the credit bid was underfunded and, therefore, it is evidence of their collusion. Mission does not acknowledge, however, that at the October 2, 2015 hearing on the Sale Motion, S&S agreed to modifications of the bidding procedures to resolve Mission's objections and to allow the sale to proceed. S&S agreed that only the amount of the post-petition loans made prior to the Auction would be included in its credit bid, and it reserved its right to credit bid its pre-petition debt.[7] Mission did not object to this modification. Thus, Mission's argument that the S&S Final Bid was improper because it was partly based on "unadvanced funds" is unjustified and does not require us to conclude the bankruptcy court's good faith finding was clearly erroneous.

Mission also points to the off-the-record negotiations between the Debtor and S&S as "direct evidence" of collusion. As the bankruptcy court found, however, the parties were informed at the beginning of the Auction that off-the-record negotiations were permitted and Mission did not object at that time. In addition, Mission has not explained how these negotiations tainted the Auction. Moreover, although Mission cites to In re Family Christian, supra, for the proposition that offthe-record communications ***519** during an auction are inappropriate and will invalidate a sale to an insider, it misconstrues the holding in that case. In In re Family Christian, the bankruptcy court was "troubled" by an off-the-record telephone call between the debtor's chief executive officer and the principal of the stalking horse during an auction. 533 B.R. at 625. Following the call, the stalking horse bidder immediately submitted its final bid and ceased additional bidding without further explanation. Id. This led the bankruptcy court to conclude the debtor may have represented to the stalking horse bidder that it would be declared the winning bidder. Id. The court found this conduct to be, at the very least, "reckless," but noted there was insufficient evidence to infer fraud. Id. at 626. The court also found, however, the debtor provided insiders with releases without explanation and without accounting for their value, and therefore, that, "although the auction was not as unfair as GBH insists, it was flawed." Id. The court ultimately determined the debtor had not satisfied its burden under the heightened scrutiny standard applied to insider sales which requires articulation of a sound business justification for selling all of its assets to an insider. Id. at 626–27. Thus, In re Family Christian does not stand for the proposition that off-the-record discussions are per se evidence of collusion requiring a finding that the proposed purchaser is not acting in good faith. Here, the bankruptcy court considered all the evidence and, noting that the opportunity for offthe-record negotiations during the Auction was expressly permitted without complaint by Mission, determined there was no evidence of collusion or fraud.

Mission also argues that the Debtor and S&S colluded to have S&S advance an additional $500,000 to the Debtor one week prior to the Auction solely for the purpose of creating the consideration for S&S' $750,000 credit bid, even though the Debtor did not need to borrow the money, as evidenced by the fact that the Debtor had $600,000 in its cash accounts as of the Auction. The bankruptcy court rejected this argument. As the court pointed out, at the Sale Hearing, Ferdinand testified that the $500,000 advance from S&S was necessary to meet payroll obligations, address liquidity concerns as he thought some of the collections from customers would be delayed, and

fund the payment of the Debtor's professionals, all of which were contemplated under the Third Interim DIP Order. Moreover, although the Debtor had $600,000 in its accounts at the November 2, 2015 Auction, only approximately $60,000 remained as of the sale closing, which supports a determination that the Debtor needed the advance from S&S.

Mission also presents a new argument on appeal—that the Debtor's post-closing sale of inventory to S&S is evidence of collusion between the parties and invalidates the bankruptcy court's good faith finding. In support, Mission cites Zuercher Trust of 1999 v. Schoenmann (In re Zuercher Trust of 1999), BAP No. NC–14–1440–KuWJu, 2016 WL 721485, at *1 (9th Cir. BAP Feb. 22, 2016), for the proposition that our examination of good faith is not limited to pre-sale circumstances, but can include facts revealed after the sale that bear on good faith. In Zuercher Trust, the panel noted:

> [W]hen any new facts come to light after the sale is completed plausibly calling into question the good faith of the buyer, the bankruptcy estate and the purchaser only can enjoy the benefit of § 363(m)'s limitation on appellate remedies when the bankruptcy court has duly considered those additional facts and has effectively ***520** determined the good faith of the purchaser in light of the additional facts.

Id.

As post-sale evidence of the collusion between the Debtor and S&S, Mission points to a motion to sell inventory pursuant to § 363(b) filed by the Debtor on February 25, 2016 ("Inventory Motion"), while this appeal was pending. According to Mission, S&S had agreed in the S&S Final Bid to leave inventory in the estate as an excluded asset, yet after the sale it required the Debtor to sell that inventory to S&S at a steep discount. This, Mission claims, is evidence that S&S was not a good faith purchaser.

First, we are not convinced that it is appropriate for an appellate court to consider post-sale events in determining whether the bankruptcy court erred in finding a purchaser was a good faith purchaser. Second, Mission mischaracterizes this particular post-petition event, by failing to acknowledge that the post-closing sale of inventory to S&S was an anticipated outcome of the sale. As the Examiner noted in his Final Report:

> The value of the assets left at Closing is uncertain. But, if the Closing occurs quickly after the approval of the sale, then the value of the assets cannot vary too much from the representations made at the auction. The largest value as represented at the auction was the inventory. The inventory is almost all finished goods inventory. The likely buyer of the inventory is S&S which (after Closing) will have just acquired a business with potential sales orders and no inventory. It will need inventory to generate accounts receivable and to satisfy its customers. The logical result should be that S&S will acquire the inventory from the estate at something close to cost and not at liquidation because its alternative is cost, but with a delay equal to the time to manufacture.

In fact, the Debtor engaged David Feller as its chief liquidation officer to liquidate its remaining assets, including inventory. Mission did not oppose the engagement. When it filed the Inventory Motion, the Debtor requested authority to sell inventory to S&S at a price which was no less than 75% of the Debtor's cost in order to give Mr. Feller maximum flexibility to liquidate the inventory on a timely basis. As anticipated by the Examiner, after a negotiation with Mr. Feller, S&S (or its designee) agreed to purchase substantially all of the Debtor's inventory at 96% of the Debtor's cost on a rolling basis. In fact, S&S ultimately agreed to purchase all of the inventory at 100% of cost on a rolling basis with all such purchases to be complete on or before September 30, 2016. The total purchase price of the inventory was approximately $1,190,000. The bankruptcy court entered an order

approving the sale of the inventory to S&S, overruling Mission's objection. Mission did not appeal the order. Thus, we conclude that the Debtor's post-closing sale of inventory to S&S does not require us to hold that the bankruptcy court's good faith finding was clearly erroneous.

Based on the record, we cannot conclude any of the bankruptcy court's findings relating to S&S' good faith were clearly erroneous or without support in the record. Mission points to no evidence that convincingly contradicts the bankruptcy court's findings or demonstrates S&S engaged in fraud, colluded with the Debtor, or attempted to take unfair advantage of other bidders. Rather, the evidence supports the bankruptcy court's findings that S&S did not interfere with the sales and marketing process. The record shows S&S agreed to extend DIP Financing for a period long ***521** enough to sustain a full marketing effort for the Debtor's assets and to conduct the sale within a reasonable time frame without the need for expedited consideration and treatment by the bankruptcy court. Additionally, the record shows S&S agreed to modification of the sale procedures and modified its offering price to allow the sale process to proceed to the Auction. In the end, the Final Report, the Sale Hearing, and the pleadings filed in support of the Sale Motion demonstrated the sale was conducted in a fair and open process. Although Mission had the opportunity to present evidence to support its allegations, Mission elected not to call its own witnesses during the Sale Hearing.

As thoroughly discussed in the Sale Order, the bankruptcy court found the bidding procedures, the negotiations with S&S, the Auction, and the Sale Hearing were conducted without collusion and in good faith. It found that S&S participated in the Auction and the Sale Hearing in good faith and bought the assets of the Debtor in good faith and for fair value; i.e., that S&S was a good faith purchaser. The bankruptcy court's findings, which were based upon a well-developed record, were not clearly erroneous and we will not disturb them.

B. Heightened Level of Scrutiny

[19] Mission also argues the bankruptcy court's determination that S&S was a good faith purchaser was clearly erroneous because it failed to apply the requisite heightened scrutiny to the sale. There is no merit to Mission's contention. First, the bankruptcy court acknowledged that it needed to apply a heightened level of scrutiny to the sale because the sale was to occur outside a confirmed plan of reorganization, and because it involved a sale to an insider. It then did so before it approved the sale.

The bankruptcy court thoroughly examined the relationship between the Debtor and S&S. In fact, because the proposed sale involved an insider making a credit bid, the bankruptcy court, at the requests of the U.S. Trustee and Mission, approved the appointment of the Examiner, who was tasked with monitoring the sale process and analyzing S&S' claims and liens. After attending the hearings and the Auction and conducting an independent investigation, the Examiner supported the sale and disagreed with Mission's allegations of collusion and misconduct. Neither the Examiner nor the U.S. Trustee questioned the propriety of the Auction or the sale to S&S. These factors, in addition to the ones discussed above, convince us that the bankruptcy court applied the appropriate level of heightened scrutiny to the sale of the Debtor's assets to S&S.

CONCLUSION

For the reasons set forth above, we **AFFIRM.**

All Citations

558 B.R. 500, 63 Bankr.Ct.Dec. 86

Footnotes

1 The sale terms required the Debtor to change its name upon the closing of the sale. The sale closed on December 18, 2015, and on December 21, 2015, the Debtor filed a notice with the New Hampshire Secretary of State changing its name from Tempnology, LLC to Old Cold, LLC. Thereafter, the Debtor filed with the bankruptcy court a motion to amend its case caption to reflect its new legal name, which the bankruptcy court granted.

2 Unless expressly stated otherwise, all references to “Bankruptcy Code” or to specific statutory sections shall be to the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. §§ 101, et seq. All references to “Bankruptcy Rule” shall be to the Federal Rules of Bankruptcy Procedure.

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3 The Debtor contends it borrowed $5,374,308 under the Term Note, and a portion of this debt ($3,500,000) was converted from debt to equity interests in the Debtor.

4 The order also included a "carve-out" provision, providing that up to $400,000 of S&S' collateral could be used to pay allowed administrative expenses and unpaid professional fees.

5 It is important to note that, in 2015, a series of significant courts of appeals decisions addressed the equitable mootness doctrine, with some debate as to whether the doctrine should continue to exist. See In re One2One Communs., LLC, 805 F.3d 428 (3d Cir. 2015); JPMCC 2007–C1 Grasslawn Lodging, LLC v. Transwest Resort Props., Inc. (In re Transwest Resort Props., Inc.), 801 F.3d 1161 (9th Cir. 2015); and Tribune Media Co., 799 F.3d 272 (3d Cir. 2015); but see Ochadleus v. City of Detroit (In re City of Detroit), 838 F.3d 792, 2016 WL 5682704 (6th Cir.2016) (noting that no circuit has yet abolished equitable mootness and, therefore, it remains a viable doctrine). The First Circuit has not weighed in on this recent debate.

6 As one court noted, there is a "good reason for allowing such transactions [to insiders]." Hower, 445 F.3d at 939. "That is, the failure of a company may be due to adverse market conditions—rather than flagrant mismanagement—and the former officers may be in the best position to make use of the assets and formulate a successful future business model." Id. "As a result, there may be circumstances where an effective repurchase of assets is the most efficient business outcome." Id. Thus, in order to encourage insolvent debtors to continue operating and generating revenue for creditors, they are permitted to sell property to insiders, so long as the insider status is disclosed at the beginning of the case, and there is no evidence of collusion. Id.

7 When discussing S&S' proposed post-petition credit bid, Mr. Desiderio (the Debtor's counsel) and Mr. Candon (S&S' counsel) stated as follows:

> MR. DESIDERIO: The stalking horse bid would be $750,000, which is the funds advanced post-petition, plus $100,000 in assumed liabilities.
>
> THE COURT: Well, that's what it has been or you expect to be?
>
> MR. DESIDERIO: Expect to be by the auction date. ...
>
> ***
>
> MR. DESIDERIO: "My understanding is that S&S would reserve the right to credit bid its full amount [as of] the auction ..."
>
> ***
>
> MR. CANDON: So with respect to the challenge period I'm anticipating, and I think this is a concession on the part of the stalking horse to do this and a way of having only the post-petition amount be the credit bid amount, that there is no need for a challenge period prior to the auction. You show up at the auction and you have a bid and if it turns out— THE COURT: Well, you—if—you're saying that the credit bid is limited to the numbers that you've—he's mentioned.
>
> MR. CANDON: Reserving our rights to credit bid the amount of our secured claim.

End of Document

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559 B.R. 809
United States Bankruptcy
Appellate Panel of the First Circuit.

In re Tempnology LLC, n/
k/a Old Cold, LLC, Debtor.
Mission Product Holdings, Inc., Appellant,
v.
Tempnology LLC, n/k/a Old Cold, LLC, Appellee.

BAP NO.
NH
15
–
065
|
Bankruptcy Case No. 15–11400–JMD
|
November 18, 2016

Synopsis

Background: Chapter 11 debtor moved for determination of what rights exclusive distributor of its products and licensee of its intellectual property retained as result of election that it made following debtor's rejection of underlying agreement between parties. The United States Bankruptcy Court for the District of New Hampshire, J. Michael Deasy, J., 541 B.R. 1, ruled that distributor/ licensee had no remaining distribution rights or rights in debtor's trademarks or logo, and distributor/licensee appealed.

Holdings: The Bankruptcy Appellate Panel, Hoffman, J., held that:

[1] exclusive right to distribute Chapter 11 debtor'spatented products, which debtor granted, along with license to intellectual property itself, to counter-party to executory contract later rejected by debtor, was not itself a right to "intellectual property," of kind which counterparty could retain by its statutory election;

[2] while Chapter 11 debtor's trademark and logo were notencompassed within categories of "intellectual property" entitled to special protections upon rejection of executory licensing agreement by debtor, debtor's rejection of its executory product distribution and licensing agreement did not vaporize licensee's trademark rights; and

[3] bankruptcy court could determine scope of licensee'sremaining rights under executory product distribution and intellectual property licensing agreement, as result of statutory election which it made upon debtor's rejection of agreement, in context of debtor's motion to reject, without requiring debtor to commence adversary proceeding.

Affirmed in part and reversed in part.

West Headnotes (12)

[1] Bankruptcy

Finality

Bankruptcy court's determination of effects of statutory post-rejection election by licensee of debtor's intellectual property completely resolved all of the issues pertaining to discrete dispute within larger bankruptcy case, and was "final order" from which appeal would lie as of right. 11 U.S.C.A. § 365(n); 28 U.S.C.A. § 158(a)(1).

Cases that cite this headnote

[2] Bankruptcy

Conclusions of law; d e novo review

Bankruptcy

Clear error

Bankruptcy Appellate Panel reviews bankruptcy court's findings of fact for clear error and its conclusions of law de novo. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[3] Bankruptcy

Conclusions of law; d e novo review

Bankruptcy court's interpretation of executory licensing agreement between Chapter 11 debtor and licensee of its intellectual property, and of bankruptcy statute dealing with licensee's rights upon rejection of underlying agreement,

involved questions of law, that were reviewable de novo on appeal. 11 U.S.C.A. § 365(n).

Cases that cite this headnote

[4] Bankruptcy

Effect of Acceptance or Rejection

In the event that bankrupt licensor rejects an intellectual property license, bankruptcy statute allows licensee to retain its licensed rights, along with its duties, absent any obligations owed by debtor-licensor. 11 U.S.C.A. § 365(n).

Cases that cite this headnote

[5] Bankruptcy

Effect of Acceptance or Rejection

Patents

Revocation, forfeiture, or other termination of license

Exclusive right to distribute Chapter 11 debtor's patented products, which debtor granted, along with license to intellectual property itself, to counter-party to executory contract later rejected by debtor, was not itself a right to "intellectual property," of kind which counter-party could retain by statutory election that it made upon debtor's rejection of this executory agreement. 11 U.S.C.A. § 365(n).

Cases that cite this headnote

[6] Bankruptcy

Effect of Acceptance or Rejection

Executory contract which may be subject to election rights of licensee of debtor's intellectual property can contain terms and provisions unrelated to licensing of intellectual property, and upon rejection of such a contract, the licensee's statutory election applies only to its rights to intellectual property and not to any other rights that it may have received under the executory contract. 11 U.S.C.A. § 365(n).

Cases that cite this headnote

[7] Statutes

Language

Courts must presume that legislature says in statute what it means and means in statute what it says there.

Cases that cite this headnote

[8] Statutes

Plain, literal, or clear meaning; ambiguity

If statute is unambiguous, then court need not resort to legislative history to construe its meaning.

Cases that cite this headnote

[9] Bankruptcy

Equitable powers and principles

Bankruptcy

Carrying out provisions of Code

What the Bankruptcy Code provides, a judge cannot override by declaring that enforcement would be inequitable.

Cases that cite this headnote

[10] Bankruptcy

Effect of Acceptance or Rejection

Rejection of executory contract by debtor does not terminate the contract, but merely relieves debtor of obligations thereunder. 11 U.S.C.A. § 365(a).

Cases that cite this headnote

[11] Bankruptcy

Effect of Acceptance or Rejection

Trademarks

Duties, rights, and violations

While Chapter 11 debtor's trademark and logo were not encompassed within categories of "intellectual property" entitled to special

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protections upon rejection of executory licensing agreement by debtor, debtor's rejection of its executory product distribution and licensing agreement did not vaporize licensee's trademark rights under agreement; whatever post-rejection rights licensee retained in debtor's trademark and logo were governed by terms of agreement, which remained in effect and was not terminated, and by applicable nonbankruptcy law. 11 U.S.C.A. § 365(n).

Cases that cite this headnote

[12] Bankruptcy

Proceedings

Bankruptcy

Harmless error

Bankruptcy court could determine scope of licensee's remaining rights under executory product distribution and intellectual property licensing agreement, as result of statutory election which it made upon debtor's rejection of agreement, in context of debtor's motion to reject, without requiring debtor to commence adversary proceeding; even assuming that adversary proceeding was technically required, any error by bankruptcy court was harmless, given that neither party expressed the need for, or engaged in, any discovery, and that there were no facts that were in dispute. 11 U.S.C.A. § 365(n); Fed. R. Bankr. P. 7001, 9014.

Cases that cite this headnote

***811 Appeal from the United States Bankruptcy Court for the District of New Hampshire (Hon. J. Michael Deasy,
U.S. Bankruptcy Judge)**

Attorneys and Law Firms

Robert J. Keach, Esq., and Michael A. Siedband, Esq., on brief for Appellant.

Daniel W. Sklar, Esq., Christopher Desiderio, Esq., and Lee Harrington, Esq., on brief for Appellee.

Before Lamoutte, Hoffman, and Cary, United States Bankruptcy Appellate Panel Judges.

Opinion

Hoffman, U.S. Bankruptcy Appellate Panel Judge.

Mission Product Holdings, Inc. ("Mission") appeals from the bankruptcy court's November 12, 2015 order granting the Motion for Determination of Applicability and Scope of Mission Product Holdings, Inc.'s Election Pursuant to 11 U.S.C. § 365(n)(1)(B) (the "365(n) Motion") filed by Tempnology LLC, n/k/a Old Cold, LLC (the "Debtor").[1] At issue before the bankruptcy court was what rights Mission, as a licensee of intellectual property, retained as a result of its election under Bankruptcy Code § 365(n)[2] when the Debtor rejected the executory contract that gave rise to the license. The bankruptcy court ruled that Mission retained its nonexclusive license to use the Debtor's intellectual property as set forth in the rejected contract, but not its exclusive product distribution rights or right to use the Debtor's trademark and logo also contained in the contract. For the reasons set forth below, we **AFFIRM IN PART** and **REVERSE IN PART**.

BACKGROUND

I. Events Preceding Bankruptcy Prior to a sale of substantially all its assets in 2015, the Debtor was a Portsmouth, New Hampshire-based material innovation company that developed chemicalfree cooling fabrics for use in consumer products under the brand name "Coolcore." Mission is in the business of marketing and distributing innovative sports technologies.

On November 21, 2012, the Debtor and Mission entered into a Co–Marketing and Distribution Agreement (the "Agreement"). In section 1 of the Agreement, entitled "Territory," the Debtor granted Mission exclusive distribution rights within the United States and "first rights of notice and of refusal in certain other countries" (collectively defined in the Agreement as the "Exclusive Territory") with respect to an array of the Debtor's products defined as "Cooling Accessories" and identified on Exhibit A of the Agreement. The Debtor also granted Mission the

non-exclusive right to sell Cooling Accessories anywhere else in the world.

***812** In section 5 of the Agreement, entitled "Product Exclusivity," the Debtor agreed that in the Exclusive Territory it would not license or sell certain specified Cooling Accessories, defined in the Agreement as "Exclusive Cooling Accessories," to anyone other than Mission during the term of the Agreement.[3]

In section 6, entitled "Distribution Exclusivity and Collaboration," the Debtor agreed that in the Exclusive Territory it would not sell *any* Cooling Accessories and certain other products directly or indirectly to any sporting goods and sport specialty retailers.

Section 7 of the Agreement, entitled "Cooperation and Further Assurances," provided:

> [T]hat (i) [the Debtor] shall take no actions to directly or indirectly frustrate its exclusivity obligations hereunder; (ii) [the Debtor] shall fully cooperate with [Mission] to ensure that no third parties take any actions that frustrate the purposes of the exclusivity provisions herein, and (iii) [the Debtor] shall take such actions as are necessary to enforce [the Debtor]'s intellectual property rights and contractual rights against third parties.

In section 15 of the Agreement, entitled "Intellectual Property," the Debtor granted Mission the following nonexclusive license (the "IP License"):

> Excluding those elements of the CC Property consisting of Marks [and] Domain Names, [the Debtor] hereby grants [Mission] and its agents and contractors a nonexclusive, irrevocable, royalty-free, fully paid-up, perpetual, worldwide, fully-transferable license, with the right to sublicense (through multiple tiers), use, reproduce, modify, and create derivative work based on and otherwise freely exploit the CC Property in any manner for the benefit of [Mission], its licensees and other third parties.

The Agreement defined "CC Property" as:

> [A]ll products (including without limitation the Cooling Accessories), personal products, inventions, designs, discoveries, improvements, innovations, ideas, drawings, images, works of authorship, formulas, methods, techniques, concepts, configurations, compositions of matter, packaging, labeling, software applications, databases, computer programs as well as other creative content, methodologies and materials in existence prior to this Agreement (or created outside the scope of this Agreement) or developed or provided by [the Debtor] hereunder and all *Intellectual Property Rights* with respect to any of the foregoing, excluding any materials provided by [Mission].

(emphasis added). With respect to the Debtor's trademark and logo which were excluded from the IP License, section 15(d) of the Agreement granted Mission a limited license to use the Debtor's Coolcore trademark and logo as follows:

> During the Term of the Agreement and the Wind–Down Period, [the Debtor] grants to [Mission] a nonexclusive, non-transferable, limited license, which shall expire upon the termination of this Agreement except as necessary to allow either party to exercise its rights during the Wind–Down Period, to use its Coolcore trademark and logo (as well as any other Marks licensed hereunder) for the limited purpose of performing its obligations ***813** hereunder, exercising its rights and promoting the purposes of this Agreement as contemplated herein....

The upshot of the Agreement was that during the term of the Agreement Mission enjoyed the exclusive right to sell the Cooling Accessories to sporting goods retailers in the United States and potentially certain other countries, and the exclusive right to sell Exclusive Cooling Accessories to anyone in that same territory. Additionally, Mission received a non-exclusive but perpetual license to exploit the Debtor's intellectual property and a limited license during the term of the Agreement to exploit the Coolcore brand and logo.

The Agreement had an initial term of two years and was subject to automatic renewal for additional oneyear periods. Either party could terminate the Agreement with or without cause by providing written notice. Any event of termination, however, would trigger a two-year wind-down period during which Mission would retain certain rights to purchase, distribute, and sell the Cooling Accessories in accordance with the Agreement.

On June 30, 2014, Mission exercised its rights to terminate the Agreement without cause, triggering the two-year wind-down period. On July 22, 2014, the Debtor issued a notice of termination for cause, asserting that Mission had breached the Agreement. The ensuing dispute resulted in a two-phase arbitration process. On June 10, 2015, the arbitrator rendered a decision in the first phase of the arbitration, determining that the Agreement remained "in full force and effect." The second phase of the arbitration —as to whether either party had breached the Agreement —did not get very far as the Debtor's bankruptcy, and accompanying stay, brought the arbitration to a halt.

II. The Bankruptcy Case

On September 1, 2015, the Debtor filed a voluntary petition for reorganization under chapter 11 of the Bankruptcy Code. The next day, the Debtor filed a motion seeking authority to reject certain of its executory contacts, including the Agreement. The Debtor also filed a motion asking the bankruptcy court to approve the sale of substantially all of its assets free and clear of liens, claims, encumbrances, and other interests.

Mission filed an objection to the sale motion and the rejection motion, which included its notice of election pursuant to § 365(n)(1)(B). In its objection, Mission argued that notwithstanding the Debtor's rejection of the Agreement, by making an election under § 365(n) Mission retained its exclusive product distribution rights as well as its rights under the IP License and the limited trademark license and that it could continue to exercise and exploit all those rights without interference from the Debtor or the purchaser of the Debtor's assets. Mission maintained that any sale of the Debtor's assets would be subject to, not free and clear of, Mission's rights under the Agreement.

The Debtor disagreed with Mission's view of the implications of its § 365(n) election. According to the Debtor, § 365(n) protects a non-debtor licensee's rights to intellectual property when a debtor rejects a license agreement embodying intellectual property, not other rights under the contract such as distribution rights. The Debtor contended that the exclusive product distribution provisions in the Agreement did not grant Mission a right to intellectual property but rather addressed the scope of available product distribution rights and, therefore, those distribution rights were not protected by the § 365(n) election.

After an initial hearing, the bankruptcy court entered an order authorizing the ***814** Debtor's rejection of certain executory contracts, but deferred its determination of the Debtor's proposed rejection of the Agreement. After additional briefing and another hearing, the bankruptcy court entered an order regarding rejection of the Agreement. The order provided in its entirety:

> The motion to reject the contract of Mission Product Holdings pursuant to 11 U.S.C. § 365(a) is granted and the contract is rejected as of the petition date subject to Mission Product Holdings' election to preserve its rights under 11 U.S.C. § 365(n).

This prompted the Debtor to file the 365(n) Motion, seeking a determination that Mission's post-rejection rights were limited exclusively to the IP License and that the balance of Mission's rights under the Agreement, including any exclusive product distribution rights or the right to use the Debtor's trademark and logo, did not survive rejection. Mission objected on the ground that its § 365(n) election also protected its exclusive product distribution rights and the right to use the Debtor's trademark and logo for the remainder of the wind-down period. Mission also claimed that the 365(n) Motion was procedurally defective because a request for a determination as to the scope of Mission's

property rights in the Debtor's intellectual property required the commencement of an adversary proceeding pursuant to Bankruptcy Rule 7001(2).

After a non-evidentiary hearing, the bankruptcy court entered the order being appealed (the "365(n) Order") granting the 365(n) Motion and ruling: (1) Mission's election pursuant to § 365(n) protected Mission rights as a non-exclusive licensee only as to any patents, trade secrets, and copyrights as were granted to Mission in section 15(b) of the Agreement (the section identifying the property subject to the IP License); (2) Mission's election pursuant to § 365(n) provided no protectable interest in the Debtor's trademarks or trade names; and (3) Mission's election pursuant to § 365(n) provided no protectable interest in the Debtor's "Exclusive Products" and the "Exclusive Territory" as those terms were defined in the Agreement.

In its accompanying Memorandum Opinion,[4] the bankruptcy court first determined that the protections of § 365(n) extended only to the intellectual property rights granted to Mission in the Agreement. The court examined the provisions of the Agreement granting Mission exclusive distribution rights, and concluded that, even though the products to which it applied, namely the Cooling Accessories, were patented, the exclusive distribution rights did not constitute a license of intellectual property and therefore were outside the protection afforded under § 365(n). The court determined that the exclusive distribution rights granted to Mission were unrelated to the IP License and thus although the IP License was protected under § 365(n), the distribution rights were not.

With respect to the Debtor's trademarks, the bankruptcy court concluded that, to the extent the Agreement granted Mission a non-exclusive right to use certain of the Debtor's trademarks and trade names, § 365(n) did not protect Mission's trademark license post-rejection, and, as a result, "Mission does not retain rights to the Debtor's trademarks and logos post-rejection." In so ruling, the court adopted the view articulated in cases such as In re Old Carco LLC, 406 B.R. 180 (Bankr. S.D.N.Y. 2009), that because the Bankruptcy Code's definition of "intellectual property" set forth in § 101(35A) does not include trademarks and trade names, those ***815** categories of intellectual property are not protected under § 365(n). The court declined to follow In re Crumbs Bake Shop, Inc., 522 B.R. 766 (Bankr. D.N.J. 2014), which held that it was improper to draw a negative inference from the absence of any reference to trademarks and trade names in § 101(35A) for purposes of applying § 365(n) and that bankruptcy courts must exercise their equitable powers on a case-by-case basis to determine whether trademark licensees may retain their rights under § 365(n).

Finally, with respect to Mission's procedural argument, the bankruptcy court determined that the parties' dispute over the scope and applicability of § 365(n) arose as a result of the Debtor's rejection of the Agreement, which gave rise to a contested matter under Bankruptcy Rule 9014 and, therefore, the Debtor was not required to commence an adversary proceeding in order to obtain an adjudication of the 365(n) Motion.

JURISDICTION

[1] The Panel has jurisdiction to hear appeals from final judgments, orders, and decrees of the bankruptcy court. See 28 U.S.C. § 158(a)(1). In the bankruptcy context, an order is "final" if it completely resolves "all of the issues pertaining to a discrete dispute within the larger proceeding." Morse v. Rudler (In re Rudler), 576 F.3d 37, 43 (1st Cir. 2009) (quoting Perry v. First Citizens Fed. Credit Union (In re Perry), 391 F.3d 282, 285 (1st Cir. 2004)). The 365(n) Order resolved conclusively what rights were preserved by Mission's § 365(n) election in response to the Debtor's rejecting the Agreement and, therefore, it is final. Thus, the Panel has jurisdiction to hear this appeal. See In re Spansion, Inc., 507 Fed.Appx. 125, 127 (3d Cir. 2012) (considering appeal of bankruptcy court order determining creditor did not retain any rights pursuant to § 365(n) because the agreement between the parties was not a license); In re Exide Techs., 607 F.3d 957, 961 (3d Cir. 2010) (considering appeal of order holding agreement was executory contract and rejection of the agreement terminated creditor's rights under the agreement).

STANDARD OF REVIEW

[2] [3] The Panel reviews a bankruptcy court's findings of fact for clear error and its conclusions of law de novo. Jeffrey P. White & Assocs., P.C. v. Fessenden (In re Wheaton), 547 B.R. 490, 496 (1st Cir. BAP 2016) (citation omitted). This appeal concerns the bankruptcy court's interpretation of the Agreement and the relevant provisions of the Bankruptcy Code—questions of law reviewed de novo. See OfficeMax,

Inc. v. Levesque, 658 F.3d 94, 97 (1st Cir. 2011) ("Contract interpretation, when based on contractual language without resort to extrinsic evidence, is a 'question of law' that is reviewed *de novo*.") (citation omitted); Boston & Me. Corp. v. Mass. Bay Transp. Auth., 587 F.3d 89, 98 (1st Cir. 2009) ("[W]e review de novo issues of statutory interpretation ...."); United States v. Yellin (In re Weinstein), 272 F.3d 39, 42 (1st Cir. 2001) ("A question of the interpretation of the Bankruptcy Code, like any other question of statutory interpretation, is a question of law that we review de novo.") (citation omitted). "De novo review means that the appellate court is not bound by the bankruptcy court's view of the law." O'Rorke v. Porcaro, 545 B.R. 384, 394 (1st Cir. BAP 2016) (citation omitted) (internal quotations omitted).

DISCUSSION

I. Applicable Law

Section 365(a) permits a trustee or debtor-in-possession, subject to court approval, to assume or reject any executory contract ***816** of the debtor. The rejection of an executory contract constitutes a breach of the contract as of the bankruptcy petition filing date, entitling the counter-party to damages. 11 U.S.C. § 365(g). Section 365(n) allows a counter-party who is the licensee under an intellectual property license to elect to retain certain rights under the contract notwithstanding the debtor's rejection. It provides, in relevant part, as follows:

> (n)(1) If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect—
>
> ...
>
> (B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced, for—
>
> (i) the duration of such contract; and
>
> (ii) any period for which such contract maybe extended by the licensee as of right under applicable nonbankruptcy law.
>
> (2) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, under such contract—
>
> (A) the trustee shall allow the licensee to exercise suchrights;
>
> (B) the licensee shall make all royalty payments dueunder such contract for the duration of such contract and for any period described in paragraph (1)(B) of this subsection for which the licensee extends such contract; and
>
> (C) the licensee shall be deemed to waive—
>
> (i) any right of setoff it may have with respectto such contract under this title or applicable nonbankruptcy law; and
>
> (ii) any claim allowable under section 503(b) of thistitle arising from the performance of such contract.

11 U.S.C. § 365(n)(1) & (2).

Section 365(n)(3)(B) provides:

> If the licensee elects to retain its rights ... then on the written request of the licensee the trustee shall ... not interfere with the rights of the licensee as provided in such contract ... to such intellectual property (including such embodiment) including any right to obtain such intellectual property (or such embodiment) from another entity.

11 U.S.C. § 365(n)(3)(B).

[4] "Thus, in the event that a bankrupt licensor rejects an intellectual property license, § 365(n) allows a licensee to retain its licensed rights—along with its duties—absent any obligations owed by the debtor-licensor." In re Exide Techs., 607 F.3d at 966. Upon the licensee's election to retain its rights, the trustee or debtor-in-possession must allow the licensee to exercise those rights free from interference. 11 U.S.C. § 365(n)(2), (3).

Congress enacted § 365(n) in 1988 in response to the U.S. Court of Appeals for the Fourth Circuit's decision in Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1048 (4th Cir. 1985), in which the court held that rejection of an intellectual property license deprived the licensee of all rights previously granted under the license. Lubrizol was widely criticized and the legislative history of § 365(n) makes it clear that Congress intended to overrule it. See ***817** S. Rep. No. 100–505, 5 (1988), reprinted in 1988 U.S.C.C.A.N. 3201–3202. Lawmakers were concerned that technologists would respond to Lubrizol by insisting on outright assignments of intellectual property rather than agree to a licensing arrangement that could evaporate in the event of bankruptcy. Id. Seeing this as a threat to the system of licensing of intellectual property that had evolved in the United States, the Senate Report states that the purpose of § 365(n) was "to make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off as a result of the rejection of the license pursuant to [§] 365 in the event of the licensor's bankruptcy." Id.

II. Issues on Appeal

In the present case, it is undisputed that, due to its § 365(n) election, Mission retained its rights under the IP License granted to it in section 15 of the Agreement and could exercise those rights free from interference by the Debtor.

Mission argues, however, that the bankruptcy court committed reversible error: (1) by ruling that Mission's § 365(n) election applied only to the IP License and not to the exclusive product distribution rights granted in the Agreement; (2) by ruling that notwithstanding its § 365(n) election Mission did not retain any rights to use the Debtor's trademark and logo because those items are not included in the Bankruptcy Code's definition of "intellectual property"; and (3) by not requiring the Debtor to bring an adversary proceeding against Mission in order to obtain the relief sought in the 365(n) Motion.

A. Whether the bankruptcy court erred in ruling that Mission's exclusive product distribution rights were not protected by its § 365(n) election.

[5] Mission argues that its exclusive product distribution rights were preserved as a result of its § 365(n) election because § 365(n) permits a licensee of intellectual property to retain its rights under the contract, "including a right to enforce *any* exclusivity provision of such contract" and "including any embodiment of such intellectual property." 11 U.S.C. § 365(n)(1)(B) (emphasis added). According to Mission, the Debtor's grant to Mission of exclusive rights to distribute Cooling Accessories in section 1 of the Agreement, and the Debtor's agreement in sections 5 and 6 not to license or sell Cooling Accessories to anyone else during the term of the Agreement, were "exclusivity provisions" and they related to the IP License because the Cooling Accessories were the "embodiment" of the Debtor's intellectual property. Thus, Mission contends, its § 365(n) election protected not only its non-exclusive IP License but also its exclusive product distribution rights.

[6] As the bankruptcy court correctly observed, and the parties do not seriously dispute, an executory contract which may be subject to a § 365(n) election can contain terms and provisions unrelated to the licensing of intellectual property. Upon rejection of such a contract, the licensee's § 365(n) election applies only to its rights to intellectual property and not to any other rights that it might have received under the executory contract. To conclude otherwise would allow the narrow exception of § 365(n) to upend the very purpose of § 365. Any executory contract could be made "rejection proof" by inserting in it an intellectual property license no matter how remote or untethered the license provision was from the other terms of the agreement.

The Agreement here deals with far more than the licensing of intellectual property. As reflected in its title, "Co– ***818** Marketing and Distribution Agreement," it confers on Mission the exclusive right to distribute the Debtor's products, namely its Cooling Accessories, in the United States and elsewhere around the world. Even a cursory reading of the Agreement makes it clear that the parties had two independent goals in entering into the Agreement: first, to grant Mission the right to distribute certain of the Debtor's products on an exclusive basis in a defined territory during a limited period; and second, to grant Mission a non-exclusive license to use some of the Debtor's intellectual property in perpetuity.

Mission also argues that the Debtor actually granted Mission two separate intellectual property licenses in the Agreement—the non-exclusive IP License provided in section 15 and an implied exclusive intellectual property license to defined products in a defined territory provided in sections 1, 5, 6, and 7 of the Agreement. According to Mission, the provisions by which the Debtor agreed that it would not interfere with

Mission's product distribution rights in the Exclusive Territory and would refrain from selling or licensing the same products to third parties in that territory constituted the grant of an exclusive intellectual property license to Mission.

Mission's attempt to re-characterize its exclusive product distribution rights under the Agreement as an intellectual property license are unsupported by either the letter or the spirit of the Agreement. The product distribution provisions in sections 1, 5, 6, and 7 of the Agreement never use the terms license or intellectual property. They confer on Mission the exclusive right to sell certain of the Debtor's products in a defined territory and restrict the Debtor's ability to do the same, nothing more. These rights would have been viable and valuable even if the Agreement had not gone on to grant Mission the IP License.

Nor does the fact that the product distribution rights happen to be exclusive allow Mission's § 365(n) election to extend to those rights. The parenthetical reference in § 365(n)(1)(B) to "a right to enforce any exclusivity provision of such contract" refers "to such intellectual property." Thus, exclusivity provisions unrelated to an intellectual property license such as the exclusive product distribution rights in the Agreement are not protected by a § 365(n) election.

We conclude that the bankruptcy court did not err in ruling that the exclusive product distribution rights granted to Mission in the Agreement were unprotected by its § 365(n) election.

B. Whether the bankruptcy court erred in ruling that Mission's rights in the Debtor's Coolcore trademark and logo were not protected by its § 365(n) election and, therefore, Mission did not retain any rights to the trademark and logo post-rejection.

While the purpose of § 365(n) is to protect licensees of intellectual property, the section does not define the term "intellectual property." Section 101(35A) does. It provides:

The term "intellectual property" means—

(A) trade secret;

(B) invention, process, design, or plant protectedunder title 35 [relating to patents];

(C) patent application;

(D) plant variety;

(E) work of authorship protected under title 17 [relating to copyrights]; or

***819** (F) mask work protected under chapter 9 of title 17 [relating to microchips];

to the extent protected by applicable nonbankruptcy law.

11 U.S.C. § 101(35A). Conspicuously absent from the Code's definition are trademarks and trade names.[5]

After Congress enacted § 365(n), several courts directly addressed the issue of whether trademarks are protected under the statute. Some courts reasoned by negative inference that the omission of trademarks from § 101(35A) means that trademark licenses are not afforded any protection under § 365(n) and therefore electing licensees have no rights to use trademarks post-rejection. See, e.g., In re Old Carco LLC, 406 B.R. at 211 (holding that "[t]rademarks are not 'intellectual property' under the Bankruptcy Code" and, therefore, § 365(n) did not entitle licensees to retain their rights with respect to trademarks or to continue using them post-rejection); In re HQ Global Holdings, Inc., 290 B.R. 507, 513 (Bankr. D. Del. 2003) ("[S]ince the Bankruptcy Code does not include trademarks in its protected class of intellectual property, Lubrizol controls and the Franchisees' right to use the trademarks stops on rejection."); Raima UK Ltd. v. Centura Software Corp. (In re Centura Software Corp.), 281 B.R. 660, 674–75 (Bankr. N.D. Cal. 2002) ("Because § 365(n) plainly excludes trademarks, the court holds that [the licensee] is not entitled to retain any rights in [the licensed trademarks] under the rejected ... [t]rademark [a]greement.").

Other courts have expressed the view that reasoning by negative inference is inappropriate in the context of the rejection of trademark licenses and the scope of the § 365(n) election. See, e.g., In re Exide Techs., 607 F.3d at 966 (Ambro, J., concurring) ("I believe such reasoning [by negative inference] is inapt for trademark license rejections.");[6] ***820** In re Crumbs Bake Shop, Inc., 522 B.R. at 772. Courts applying this approach rely on the legislative history of § 365(n), concluding that "Congress intended the bankruptcy courts to exercise their equitable powers to decide, on a case[-]by[-]case basis, whether trademark licensees may retain the rights listed under § 365(n)." In re Crumbs Bake

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Shop, Inc., 522 B.R. at 772 (adopting rationale set forth by Judge Ambro in In re Exide Techs.). After considering the equities, the court in In re Crumbs Bake Shop, Inc. concluded that it would be inequitable to strip the trademark licensees of their rights under § 365(n) in the event of a rejection, as those rights were bargained away by the debtors.

> Courts may use § 365 to free a bankrupt trademark licensor from burdensome duties that hinder its reorganization. They should not ... use it to let a licensor take back trademark rights it bargained away. This makes bankruptcy more a sword than a shield, putting debtorlicensors in a catbird seat they often do not deserve.

Id. (quoting In re Exide Techs., 607 F.3d at 967–68).

In Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC, 686 F.3d 372 (7th Cir. 2012), the U.S. Court of Appeals for the Seventh Circuit declined to follow either approach in its entirety. While the Seventh Circuit agreed that a § 365(n) election does not protect licensee rights in trademarks due to the omission of trademarks from the definition of intellectual property, it rejected both the line of authority embracing Lubrizol's holding that a trademark license is terminated upon rejection and the reasoning of Judge Ambro that equitable principles could preserve a licensee's rights in trademarks post-rejection. Instead, the Seventh Circuit held that the debtor's rejection of a trademark license, which was part of a supply agreement that related to the manufacturing and sale of electric fans by a third party, did not automatically extinguish the licensee's right to use the debtor's trademarks. In response to cases such as In re Old Carco, LLC, supra, the court stated that "an omission is just an omission. The limited definition in § 101(35A) means that § 365(n) does not affect trademarks one way or the other." Id. at 375. The court examined the legislative history of § 365(n) and suggested that "the omission [of trademarks from the definition] was designed to allow more time for study, not to approve Lubrizol." Id. (citations omitted). It then rejected any equity-based attempt to circumvent the statutory omission, stating that "[r]ights depend ... on what the Code provides rather than on notions of equity." Id. at 376.

The Seventh Circuit determined it was more appropriate to focus on § 365(g), which sets forth the consequences of a rejection under § 365(a). Under § 365(g) "the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease ...." 11 U.S.C. § 365(g). By classifying rejection as a breach, § 365(g) establishes that in bankruptcy, as outside of it, the non-rejecting party's rights remain in place. Sunbeam, 686 F.3d at 377. Thus, rejection does not terminate the contract. Id. at 377–78. "[R]ejection is not the functional equivalent of a rescission [as Lubrizol suggests], rendering void the contract and requiring that the parties be put back in ***821** the positions they occupied before the contract was formed .... It merely frees the estate from the obligation to perform and has absolutely no effect upon the contract's continued existence." Id. at 377 (citations omitted) (internal quotations omitted).

Here, the bankruptcy court, after considering both the negative inference and equity-based lines of authority, adopted the former.[7] The court, noting that § 101(35A) identifies six categories of intellectual property that are subject to protection under § 365(n), none of which includes trademarks, concluded:

> Under the maxim of *expressio unius est exclusio alterious* the expression of one thing is the exclusion of other things, see, e.g., United States v. Hernandez–Ferrer, 599 F.3d 63, 67–68 (1st Cir. 2010)[,] the omission of trademarks from the definition of intellectual property in § 101(35A) indicates that Congress did not intend for them to be treated the same as the six identified categories.

In re Tempnology, LLC, 541 B.R. at 8. Thus, the bankruptcy court ruled that Mission "does not retain rights to the Debtor's trademarks and logos postrejection." Id.

Although Mission acknowledges that the definition of intellectual property in § 101(35A) does not encompass the Debtor's trademark and logo, it argues that the bankruptcy court should have used its equitable powers to determine that Mission's rights in the Debtor's trademark and logo were protected by § 365(n). According to Mission, the legislative history of § 365(n) makes it clear that the statute's failure to encompass trademarks within the definition of intellectual property protected upon

rejection was intended, not to resurrect the draconian result in Lubrizol, but to allow courts to determine on a case-by-case basis whether trademark rights should be preserved under § 365(n) on equitable grounds. Mission maintains, because the parties bargained for trademark rights under the Agreement, and because the Debtor's trademark and logo are inseparable from the Debtor's other intellectual property and the products themselves, that Mission's election to preserve its licensee rights should include its rights in the Debtor's trademark and logo.

The Debtor contends, however, that the bankruptcy court properly adopted the negative inference approach and that Lubrizol applies to the Debtor's trademark and logo. According to the Debtor, Congress unambiguously defined the types of intellectual property entitled to protection under § 365(n), and it did not include trademarks in any of the protected categories. The Debtor maintains that courts may not look to legislative history to interpret unambiguous statutes and because the statute here is clear, there is no need to look to the legislative history to understand the scope of § 365(n). Thus, the Debtor maintains, the bankruptcy court correctly held that § 365(n) does not apply to the Debtor's trademark and logo and, therefore, Mission does not have a "protectable interest in the Debtor's trademarks that survive[d] rejection...."

[7] [8] [9] We agree that § 365(n) incorporates the definition of intellectual property set forth in § 101(35A), and that the definition does not encompass trademarks and logos. But we decline Mission's invitation to rule that, despite the omission of trademarks from the Code's definition of intellectual property, Mission's licensee rights in the Debtor's trademark and logo should be preserved under § 365(n) on equitable grounds as suggested in § 365(n)'s legislative history. "[C]ourts must presume that a legislature says in a statute what it ***822** means and means in a statute what it says there." Conn. Nat'l Bank v. Germain, 503 U.S. 249, 253–54, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992) (collecting authorities). Thus, if a statute is unambiguous, the court need not resort to legislative history to construe its meaning. Moreover, "[w]hat the Bankruptcy Code provides, a judge cannot override by declaring that enforcement would be 'inequitable.' " Sunbeam, 686 F.3d at 375. While it is true that the legislative history expresses the sentiment that bankruptcy courts develop the "equitable treatment" of trademarks under § 365(n), we are not bound by Congress' aspirational asseverations.

[10] We agree with the bankruptcy court that, based on a plain reading of the statute, Mission's rights in the Debtor's trademark and logo were not and could not be protected by its § 365(n) election. We must part company with the bankruptcy court, however, on the *effect* the Debtor's rejection of the Agreement had on Mission's licensee rights in the Debtor's trademark and logo. The bankruptcy court ruled that, because the Debtor's trademark and logo were not protected by Mission's election under § 365(n), Mission did "not retain rights to the Debtor's trademarks and logos post-rejection." This conclusion endorses Lubrizol's approach to the rejection of executory contracts, namely that rejection terminates the contract. Lubrizol, however, is not binding precedent in this circuit and, like the many others who have criticized its reasoning,[8] we do not believe it articulates correctly the consequences of rejection of an executory contract under § 365(g). We adopt Sunbeam's interpretation of the effect of rejection of an executory contract under § 365 involving a trademark license.

> What § 365(g) does by classifying rejection as breach is establish that in bankruptcy, as outside of it, the other party's rights remain in place. After rejecting a contract, a debtor is not subject to an order of specific performance. See NLRB v. Bildisco & Bildisco, 465 U.S. 513, 531, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984); Midway Motor Lodge of Elk Grove v. Innkeepers' Telemanagement & Equipment Corp., 54 F.3d 406, 407 (7th Cir. 1995). The debtor's unfulfilled obligations are converted to damages; when a debtor does not assume the contract before rejecting it, these damages are treated as a prepetition obligation, which may be written down in common with other debts of the same class. But nothing about this process implies that any rights of the other contracting party have been vaporized.

Sunbeam, 686 F.3d at 377.

[11] Applying Sunbeam's rationale, we conclude that, while the Debtor's trademark and logo were not encompassed in the categories of intellectual property entitled to special protections under § 365(n), the Debtor's rejection of the Agreement did not vaporize Mission's trademark rights under the Agreement. Whatever ***823** post-rejection rights Mission retained in the Debtor's trademark and logo are governed by the terms of the Agreement and applicable non-bankruptcy law.

Thus, we conclude that the bankruptcy court did not err in ruling that Mission's § 365(n) election failed to protect its rights under the Agreement as licensee of the Debtor's trademark and logo, but it erred in ruling that Mission's rights in the Debtor's trademark and logo as set forth in the Agreement terminated upon the Debtor's rejection of the Agreement.

C. Whether the bankruptcy court erred in deciding the 365(n) Motion without requiring the Debtor to commence an adversary proceeding?

[12] Mission argues that the bankruptcy court committed error in deciding the 365(n) Motion without requiring the Debtor to commence an adversary proceeding under Bankruptcy Rule 7001. The bankruptcy court viewed the dispute as to the scope and applicability of § 365(n) in the context of the Debtor's motion to reject the Agreement, from which it arose, treating it is a contested matter under Bankruptcy Rule 9014.

Bankruptcy Rule 7001 requires an adversary proceeding in order, among other things, "to determine the validity, priority or extent of a lien or other interest in property" or for a declaratory judgment relating to the foregoing. Fed. R. Bankr. P. 7001(2) & (9). According to Mission, by its 365(n) Motion, the Debtor sought a declaratory judgment regarding the enforceability of Mission's rights, how those rights related to the rights of the Debtor (or the purchaser of the Debtor's assets), and the scope of the specific property to which Mission's rights attached. Thus, Mission contends, the Debtor was seeking a final determination of the extent of Mission's rights in certain property, including its rights to the Debtor's intellectual property, and the matter could only be adjudicated through an adversary proceeding.

In support, Mission cites In re Eastman Kodak Co., No. 12–10202, 2012 WL 2255719 (Bankr. S.D.N.Y. June 15, 2012), contending that the 365(n) Motion requested relief "that is nearly identical to the relief sought in In re Eastman Kodak ...." In that case, Eastman Kodak Company and certain affiliates planned to sell its digital imaging patents as part of its chapter 11 reorganization efforts. Two parties, Apple Inc. and FlashPoint Technology, Inc., disputed Kodak's ownership of ten digital imaging patents. Kodak filed a motion for an order in aid of the planned sale requesting a finding that Apple and FlashPoint had no ownership interests in the disputed patents and permitting a sale free and clear of their claims. Apple and FlashPoint objected, asserting, among other things, that the motion was procedurally improper because their ownership rights could not be determined summarily by motion. The bankruptcy court agreed, concluding the relief sought by Kodak was "for all intents and purposes, an action for a declaratory judgment to determine an interest in property by excluding the claimed interests of Apple and Flashpoint," and accordingly ruled that the matter had to be brought as an adversary proceeding, not as a contested motion. Id. at *2.

In contrast to the case before us, In re Eastman Kodak dealt with a dispute over ownership of property. Here, the dispute is over the scope of Mission's rights as a licensee of intellectual property in light of its election under § 365(n) after the Debtor rejected the contract giving rise to the license. Mission has never asserted ownership rights in the Debtor's property as ***824** Apple and FlashPoint did in In re Eastman Kodak.

Our case is more akin to In re The Education Resources Institute, Inc., 442 B.R. 20 (Bankr. D. Mass. 2010). In that case, the debtor, The Education Resources Institute, Inc. ("TERI"), filed a "Motion for Interpretation of Order" asking the court to interpret an order authorizing the rejection of certain contracts with The First Marblehead Corporation. Id. at 21. TERI and First Marblehead disagreed about the implications of the court's order authorizing the rejection of certain contracts between the parties, including the parties' rights with respect to TERI's loan database. First Marblehead argued that the motion should be denied, because it sought declaratory and injunctive relief and therefore must be filed as an adversary proceeding under Bankruptcy Rule 7001. The bankruptcy court disagreed, noting:

> The Court agrees with First Marblehead that, to the extent TERI asks the Court to enjoin First Marblehead from doing anything or

> asks the Court to order First Marblehead to take a particular action, Rule 7001(7) requires the filing of an adversary proceeding.... But to the extent the motion asks the Court merely to interpret the Contracts Order, a request which *does* strike the Court as one for declaratory relief, an adversary proceeding is not required.... Standing alone, TERI's request for an interpretation of the Contracts Order is not related to any of the types of relief listed in subsections (1) through (8) of that Rule and may be brought by motion as a contested matter pursuant to Bankruptcy Rules 9013 and 9014.

Id. at 23–24 (citations omitted).

The bankruptcy court also noted First Marblehead would not be prejudiced by the procedure employed. The court observed:

> There are no factual issues in dispute requiring an extended discovery period or evidentiary hearing and both parties have had a fair opportunity to fully address the relevant legal issues. Accordingly, requiring the filing of an adversary proceeding at this juncture would provide nothing other than fruitless delay.

Id. at 24 (citing In re NSCO, Inc., 427 B.R. 165, 176 n.12 (Bankr. D. Mass. 2010) (failure to file adversary proceeding excused where parties given fair opportunity to address issues in the context of a contested matter and no factual issues were in dispute); Aegean Fare, Inc. v. Massachusetts (In re Aegean Fare, Inc.), 33 B.R. 745, 746 n.1 (Bankr. D. Mass. 1983) (failure to file adversary proceeding excused where issues were clearly delineated in motion and non-moving party was able to draft detailed response)).

In this case, the Debtor filed the 365(n) Motion seeking an interpretation of the bankruptcy court's order granting the Debtor's request to reject the Agreement, and the scope of Mission's retained rights after such rejection in light of its § 365(n) election, a request which may be interpreted as one for declaratory relief. The Debtor was not seeking a determination of the validity or extent of a lien or interest in property.

In any event, even if the 365(n) Motion should have been filed as an adversary proceeding, the bankruptcy court's failure to require the Debtor to do so was harmless error as there was no prejudice to Mission. Neither party expressed the need for or engaged in any discovery. Nor were there any facts in dispute. The parties were given ample opportunity to brief all issues and were given a full and fair hearing. Requiring the Debtor to file an adversary ***825** proceeding would only have delayed resolution of the critical issues in dispute and added unnecessary expense on both sides.

In light of the foregoing, we conclude the bankruptcy court did not err in deciding the 365(n) Motion without requiring the Debtor to commence an adversary proceeding under Bankruptcy Rule 7001.

CONCLUSION

For the reasons set forth above, we **AFFIRM IN PART** and **REVERSE IN PART**. We **REVERSE** the 365(n) Order to the extent the bankruptcy court ruled that Mission's rights in the Debtor's trademark and logo as set forth in the Agreement terminated upon the Debtor's rejection of the Agreement. We **AFFIRM** all other aspects of the 365(n) Order, including the bankruptcy court's ruling that Mission's § 365(n) election did not protect its **All Citations** rights under the Agreement as licensee of the Debtor's trademark and logo.

559 B.R. 809, 63 Bankr.Ct.Dec. 106

Footnotes 1 In conjunction with a sale of its assets, the Debtor was required to change its name upon the sale closing. The closing occurred on December 18, 2015, and on December 21, 2015, the Debtor filed a notice with the New Hampshire Secretary

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of State changing its name from Tempnology LLC to Old Cold, LLC. Thereafter, the bankruptcy court granted the Debtor's motion to amend the caption of its case to reflect the name change.

2 Unless expressly stated otherwise, all references to "Bankruptcy Code" or to specific statutory sections shall be to the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. §§ 101, et seq. All references to "Bankruptcy Rule" shall be to the Federal Rules of Bankruptcy Procedure.

3 Exhibit A of the Agreement listing the Cooling Accessories provided that certain Cooling Accessories were exclusive—towels, wraps, hoodies, bandanas, "multi-chills," and doo rags—while other Cooling Accessories were identified as nonexclusive—socks, headbands, wristbands, sleeves, skull caps, yoga mats, and baselayers.

4 In re Tempnology, LLC, 541 B.R. 1 (Bankr. D.N.H. 2015).

5 Congress considered addressing the omission of trademarks from § 101(35A) when it enacted § 365(n) but ultimately chose not to do so. The Senate Report noted:

> [T]he bill does not address the rejection of executory trademark, trade name or service mark licenses by debtorlicensors. While such rejection is of concern because of the interpretation of [§] 365 by the Lubrizol court and others, ... such contracts raise issues beyond the scope of this legislation. In particular, trademark, trade name and service mark licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee. Since these matters could not be addressed without more extensive study, it was determined to postpone congressional action in this area and to allow the development of equitable treatment of this situation by bankruptcy courts[.]

In re Crumbs Bake Shop, Inc., 522 B.R. at 771–72 (quoting S. Rep. No. 100–505, at 5, reprinted in 1988 U.S.C.C.A.N. 3204) (emphasis omitted).

6 In In re Exide Technologies, the Third Circuit held that a perpetual, exclusive, and royalty-free trademark license that was part of a larger, decade-old asset-purchase agreement pursuant to which the debtor had sold a certain business unit was not executory and, therefore, could not be rejected by the debtor. 607 F.3d at 963–64. In other words, the trademark license continued to exist because the debtor could not reject the contract. In his concurring opinion, Judge Thomas L. Ambro disagreed with the bankruptcy court's determination that rejection of the contract deprived the licensee of its right to use the trademark. Id. at 964–68. He considered the line of cases that concluded by negative inference that, because Congress did not include trademarks in the definition of intellectual property, it intended Lubrizol's holding to control when a debtor rejects a trademark license. Judge Ambro opined, however, that "it is 'simply more freight than negative inference will bear' to read rejection of a trademark license to effect the same result as termination of that license." Id. at 967. He contended that, even though rejection of a contract would be a breach, rejection would not terminate the licensee's rights, and the licensee might still use a trademark even after rejection. Further, Judge Ambro maintained that, "[r]ather than reasoning from negative inference to apply another Circuit's holding," the Third Circuit should have used its "equitable powers" to allow the licensee to continue using the debtor's trademark. Id. at 967.

7 The bankruptcy court made no references to the Sunbeam decision.

8 See, e.g., In re Exide Techs., 607 F.3d at 966 (concurring opinion by Judge Ambro) (disagreeing with bankruptcy court's determination that Lubrizol and its progeny " 'retain vitality' " as they relate to trademark licenses); In re Crumbs Bake Shop, Inc., 522 B.R. at 770 ("This Court is not persuaded by the decision in Lubrizol and is not alone in finding that its reasoning has been discredited.") (citing Sunbeam, 686 F.3d at 377–78). In addition, scholars uniformly criticize Lubrizol, concluding that it confuses rejection with the use of an avoiding power. See, e.g., Douglas G. Baird, Elements of Bankruptcy 130–40 & n.10 (4th ed. 2006); Michael T. Andrew, Executory Contracts in Bankruptcy: Understanding "Rejection", 59 U. Colo. L. Rev. 845, 916–19 (1988); Jay Lawrence Westbrook, The Commission's Recommendations Concerning the Treatment of Bankruptcy Contracts, 5 Am. Bankr. Inst. L. Rev. 463, 470–72 (1997).

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2016 WL 6962086
United States Court of Appeals, First Circuit.

Parkview Adventist Medical Center, Appellant,
v.
United States of America, on behalf of the Department of Health and Human Services, Centers for Medicare & Medicaid Services, Appellee.

No.
16
-
1731
|
November 29, 2016

Synopsis
Background: In Chapter 11 case, debtor-hospital filed motion to compel post-petition performance of provider agreement governing its eligibility for Medicare reimbursement. The Bankruptcy Court denied motion, and debtor appealed. The United States District Court for the District of Maine, Jon D. Levy, J., 2016 WL 3029947, affirmed, and debtor appealed.

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

[1] termination of debtor's provider agreement did notviolate automatic stay, and

[2] termination of debtor's provider agreement did notviolate Bankruptcy Code's non-discrimination provision.

Affirmed.

West Headnotes (3)

[1] Bankruptcy

Administrative Proceedings and Governmental Action

If governmental action is designed primarily to protect public safety and welfare, it is exempt from automatic stay, but if action is attempt by government to recover property from estate, it has pecuniary purpose and so remains subject to stay. 11 U.S.C.A. § 362(b)(4).

Cases that cite this headnote

[2] Bankruptcy

Administrative Proceedings and Governmental Action

Termination of medical center's provider agreement by Centers for Medicare and Medicaid Services (CMS) after center filed bankruptcy petition, based on CMS's finding that it was no longer “hospital” under Medicare statute, was exercise of regulatory power provided in Medicare statute, and thus did not violate automatic stay, even though termination was not based on findings of threat to health or safety of patients; CMS had strong public policy interest in seeing that Medicare-program dollars were not spent on institutions that failed to meet qualification standards, applying stay against CMS would have threatened its ability to enforce generally Medicare statute's carefully articulated regulatory structure, and government did not seek any monetary recovery from center. 11 U.S.C.A. § 362(b)(4).

Cases that cite this headnote

[3] Bankruptcy

Administrative Proceedings and Governmental Actions

Termination of medical center's provider agreement by Centers for Medicare and Medicaid Services (CMS) after center filed bankruptcy petition, based on CMS's finding that it was no longer “hospital” under Medicare statute, did not violate Bankruptcy Code's non-discrimination provision, where CMS terminated provider agreement because center had decided to close its inpatient facilities, not because of its insolvency or pre-

petition debts, and center could not assure CMS that it would bring itself back into compliance with Medicare statute. 11 U.S.C.A. § 525(a).

Cases that cite this headnote

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MAINE, [Hon. Jon D. Levy, U.S. District Judge]

Attorneys and Law Firms

George J. Marcus, with whom Jennie L. Clegg, David C. Johnson, Andrew C. Helman, and Marcus Clegg were on brief, for appellant.

Jeffrey Clair, with whom Benjamin C. Mizer, Principal Deputy Assistant Attorney General, Thomas E. Delahanty II, United States Attorney, and Michael S. Raab were on brief, for appellee.

John A.E. Pottow and Asher Steinberg on brief as amicus curiae.

Before Lynch, Stahl, and Barron, Circuit Judges.

Opinion

LYNCH, Circuit Judge.

***1** This is an important case resting at the intersection of the Bankruptcy Code and Medicare law. It concerns the efforts of the Parkview Adventist Medical Center ("Parkview") in Brunswick, Maine, which filed for bankruptcy on June 16, 2015, to use the Bankruptcy Code to challenge the actions of appellee United States, through the Centers for Medicare & Medicaid Services ("CMS"), in terminating its "Provider Agreement" with Parkview and declining to reimburse Parkview for certain services provided after the effective date of that termination.

After receiving a letter from Parkview, CMS concluded that Parkview's Provider Agreement was to be terminated, because CMS found that Parkview was no longer a "hospital" under the Medicare statute. See 42 U.S.C. § 1395x(e)(1). An administrative law judge ("ALJ") has issued a determination upholding the termination but adjusting the effective date.

Both the bankruptcy court and the reviewing U.S. district court, see Parkview Adventist Med. Ctr. v. United States, No. 2:15–cv–00320–JDL, 2016 WL 3029947 (D. Me. May 25, 2016), denied Parkview's "Motion to Compel Post Petition Performance of Executory Contracts," which sought, inter alia, a "[d]etermin[ation] that the Termination Notice [from CMS] is null and void and that the Provider Agreement [governing Parkview's eligibility for Medicare reimbursement] remains in full force and effect." It also sought relief "requiring CMS to honor the terms of the Provider Agreement and [to] reimburse [Parkview] for Part B Services provided by [Parkview] from and after June 18, 2015, in accordance with the terms of the Provider Agreement," as well as "such other and further relief as is just and equitable."[1]

In this motion, Parkview argued that the Provider Agreement was an "executory contract" under 11 U.S.C. § 365, and accordingly within the bankruptcy court's jurisdiction. As such, Parkview contended, CMS's termination of the Provider Agreement was "a postpetition termination ... without court authority, and prior to the Debtor having exercised its right to assume or reject the Provider Agreement," in violation of "[11 U.S.C.] §§ 365, 362 and 525 of the Code." Parkview further argued that CMS's termination of the Provider Agreement violated (1) the "automatic stay" in 11 U.S.C. § 362(a) (3), which stays "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate," and (2) the nondiscrimination provision in 11 U.S.C. § 525(a), which provides that governmental agencies may not revoke a license or a similar grant solely on account of a party's insolvency or the fact that a party has filed a bankruptcy petition.

***2** The bankruptcy court concluded that it lacked jurisdiction over the motion until Parkview's claims were administratively exhausted and that CMS had not violated either the automatic stay or the nondiscrimination provision. The district court affirmed, reasoning that 42 U.S.C. §§ 405(g) and 405(h)
"[t]ogether ... require the exhaustion of administrative remedies through the agency review process before judicial review takes place." Parkview, 2016 WL 3029947, at *5.

Section 405(g)[2] provides in part that:

> Any individual, after any final decision of the [Secretary] made

> after a hearing to which he was a party, irrespective of the amount in controversy, may obtain a review of such decision by a civil action commenced within sixty days after the mailing to him of notice of such decision or within such further time as the [Secretary] may allow.

42 U.S.C. § 405(g). Section 405(h)[3] further provides that:

> The findings and decision of the [Secretary] after a hearing shall be binding upon all individuals who were parties to such hearing. No findings of fact or decision of the [Secretary] shall be reviewed by any person, tribunal, or governmental agency except as herein provided. No action against the United States, the [Secretary], or any officer or employee thereof shall be brought under section 1331 or 1346 of Title 28 to recover on any claim arising under this subchapter.

42 U.S.C. § 405(h). The district court concluded that Parkview's claims arose under the Medicare statute and that the final sentence of § 405(h) bars bankruptcy jurisdiction over such administratively unexhausted claims. Parkview, 2016 WL 3029947, at *6–8. The district court also affirmed the bankruptcy court's holding that CMS had not violated the automatic stay, see 11 U.S.C. § 362(a)(3), nor the non-discrimination provision, see 11 U.S.C. § 525(a). Parkview, 2016 WL 3029947, at *8.

We acknowledge that there is a circuit split on the lack-of-jurisdiction holding pertaining to § 405(h), as described by the district court.[4] As the district court correctly observed, the majority of circuits have adopted the view—based on previous versions of the statute and its legislative history—that even though § 405(h) specifically mentions a bar to jurisdiction under only 28 U.S.C. §§ 1331 (federal question jurisdiction) and 1346 (jurisdiction when the United States is a defendant), its jurisdictional bar "applies to other grants of jurisdiction under Title 28, including bankruptcy jurisdiction under § 1334."[5] Parkview, 2016 WL 3029947, at *5. Only the Ninth Circuit has clearly adopted a contrary position. See Do Sung Uhm v. Humana, Inc., 620 F.3d 1134, 1141 n.11 (9th Cir. 2010) (citing In re Town & Country Home Nursing Servs., Inc., 963 F.2d 1146, 1155 (9th Cir. 1991)); cf. In re Univ. Med. Ctr., 973 F.2d 1065, 1073 (3d Cir. 1992) (holding that § 405(h) did not preclude bankruptcy jurisdiction over an action to bar the offset of reimbursement of post-petition services against pre-petition overpayments because the claim did not "arise under" the Medicare statute). Rather than add our voice to the circuit split on this difficult issue, we choose to resolve this case on narrower grounds evident from the record.[6] We affirm.

***3** Since only statutory jurisdiction is at stake in the § 405(h) jurisdictional question and not Article III jurisdiction, we assume hypothetical jurisdiction. We have done so before when confronted with the same § 405(h) question, and we do so again here, because of the difficulty of the jurisdictional issue and because Parkview's merits claims under the Bankruptcy Code obviously fail. See In re Ludlow Hosp. Soc., Inc., 124 F.3d 22, 25 n.7 (1st Cir. 1997) ("As the [§ 405(h)] jurisdictional question is problematic, and the merits of the Trustee's appeal are not, we elect to bypass the jurisdictional issue at this time." (citations omitted)).[7]

Assuming arguendo that this case arises under the Bankruptcy Code, we affirm the denial of relief to Parkview. We do so because the record is clear that CMS did not violate the automatic stay provision. The statutory "police and regulatory power" exception to the automatic stay under 11 U.S.C. § 362(b)(4) plainly applies. It follows, then, for this and other reasons, that the nondiscrimination provision of the Code is not offended. As to the arguments Parkview makes on appeal regarding the § 365 executory contract provision of the Code, we find that Parkview's sparse briefing amounts to waiver of the issue.[8] See Aponte v. Holder, 683 F.3d 6, 10 n.2 (1st Cir. 2012).

I.

In the interests of brevity, we recite only the facts necessary to this opinion. Before its petition for bankruptcy, Parkview operated as a fifty-five-bed hospital in Brunswick, Maine. It "provided emergency

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services, inpatient services, and a variety of outpatient, ambulatory clinics and other medical services" to the community. It maintained a Provider Agreement with CMS that specified the conditions to which Parkview had to agree and adhere in order to participate in Medicare and receive reimbursements for both Part A (inpatient) and Part B (outpatient) services. See generally 42 U.S.C. §§ 1395cc(a) (1) (listing requirements of a Provider Agreement with a "provider of services"), 1395x(u) ("The term 'provider of services' means a hospital, critical access hospital, skilled nursing facility, comprehensive outpatient rehabilitation facility, home health agency, hospice program, or, for purposes of section 1395f(g) and section 1395n(e) of this title, a fund."), 1395x(e) (defining "hospital" as an institution primarily engaged in providing specified inpatient services, and listing other conditions).

Parkview sent CMS a letter dated June 15, 2015, stating that Parkview was ending its participation in Medicare. The letter stated that Parkview would be filing a voluntary chapter 11 petition on June 16, 2015 and that it would be "closing as a hospital effective upon the order of the Bankruptcy Court and will no longer participate in the Medicare Program ... as an acute care hospital provider." It further stated that Parkview "expect[ed] the Bankruptcy Court to enter its order within sixty (60) to ninety (90) days of the date of this letter." Parkview would "begin to transition acute care services to Mid Coast Hospital beginning June 18, 2015," but would "continue to provide outpatient services." Parkview filed its voluntary chapter 11 petition on June 16, 2015.[9]

***4** In a letter dated June 19, 2015, CMS replied that it would terminate the Provider Agreement as of June 18, 2015:

> Based upon information from your hospital's website, your statements to CMS, and your emergency motion filed in the District of Maine bankruptcy case 15-20442, CMS has determined that the date of voluntary termination of your Part A Medicare Provider
> Agreement is June 18, 2015. See 42 C.F.R. § 489.52(b) (1).
>
> According to the information reviewed by CMS, the hospital has closed its inpatient care services on June 18, 2015, and discharged all inpatients on or about 4:00pm on June 18, 2015. Additionally, the hospital is not accepting new inpatients, and does not plan to accept new inpatients in the future. Therefore, the hospital no longer meets the definition of "hospital," as outlined in Section § 1861(e) of the Social Security Act. See also 42 C.F.R. § 482.1. More specifically, a Medicare-participating hospital must be an institution which is primarily engaged in providing care to inpatients. Additionally, you have also requested voluntary termination of your participation in the Medicare program.
>
> Therefore, under the provisions of Federal regulations at 42 C.F.R. § 489.52(b)(1, 3), your Part A Medicare Provider Agreement with the Secretary of Health and Human Services is terminated, effective June 18, 2015. No payment under this agreement can be made under the Medicare program for services rendered on or after June 18, 2015.

On June 19, 2015, the Maine Department of Health and Human Services "issued a conditional license for Parkview to operate outpatient services during the pendency of the bankruptcy proceedings," but "did not authorize Parkview to admit inpatients." Parkview then "informed CMS that it was not terminating the Provider Agreement and that CMS'[s] decision to terminate the agreement would adversely affect Parkview's bankruptcy transition plan."[10] In response, CMS stated that it would rescind the termination if Parkview resumed admission of inpatients. Parkview then filed its motion to compel in the bankruptcy court on July 9, 2015, and this litigation ensued.[11]

II.

***5** We turn to the merits of the claims Parkview has preserved for appeal. Parkview argues that CMS's termination of the Provider Agreement violates the Code's automatic stay. See 11 U.S.C. § 362(a)(3). And it contends that the termination was an impermissible discrimination against a debtor in bankruptcy, within the meaning of 11 U.S.C. § 525(a). These claims raise issues of law subject to de novo review. Barbosa v. Solomon, 235 F.3d 31, 35 (1st Cir. 2000). Both arguments fail on the merits.

A. Automatic Stay

Parkview argues that CMS's termination of the Provider Agreement violated the automatic stay in § 362(a)(3). The statute provides that counterparties may not take "any act to obtain possession of property of the estate or

of property from the estate or to exercise control over property of the estate." 11 U.S.C. § 362(a)(3). Parkview contends that, because the Provider Agreement is an executory contract, CMS may not involuntarily terminate it. It cites a number of cases for the proposition that a counterparty may not involuntarily terminate an executory contract post-petition. See In re Mirant Corp., 440 F.3d 238, 251–53 (5th Cir. 2006); In re Comput. Commc'ns, Inc., 824 F.2d 725, 728–31 (9th Cir. 1987).

The government does not dispute that the Provider Agreement is an executory contract within the meaning of the Bankruptcy Code.[12] But it contests on a number of grounds Parkview's assertion that the termination of the Provider Agreement violates § 362(a)(3). It argues that the Provider Agreement is not "property of the estate" under the meaning of § 362(a)(3); that that automatic stay does not expand Parkview's contractual rights under the automatic stay, and that "Parkview ... has never had a cognizable property or contractual interest in participating in Medicare without meeting Medicare's conditions of participation"; and that the automatic stay does not apply to the termination because it is a "nonfinal agency action[ ]." The government further asserts that even if Parkview had a property interest in the Provider Agreement and the stay applied on its face to the termination, the "police and regulatory power" exception to the stay in 11 U.S.C. § 362(b)(4) would apply.[13] Without reaching the other arguments, we agree that the police and regulatory power exception to the stay applies to CMS's termination of the Provider Agreement.

[1] The exception provision in § 362(b)(4) provides that the automatic stay of actions against the debtor does not apply to "an action or proceeding by a governmental unit ... to enforce such governmental unit's ... police and regulatory power." In turn, under In re McMullen, 386 F.3d 320, 325 (1st Cir. 2004), we make two inquiries. We ask whether the governmental action "is designed primarily to protect the public safety and welfare." Id. If so, the government action—here the termination of the Provider Agreement—is exempt. Id. But if the action is an attempt by the government to recover property from the estate, it has a pecuniary purpose and so remains subject to the stay. Id.; see also In re Nortel Networks, Inc., 669 F.3d 128, 140 (3d Cir. 2011) ("If the purpose of the law is to promote public safety and welfare or to effectuate public policy, then the exception to the automatic stay applies. If, on the other hand, the purpose of the law is to protect the government's pecuniary interest in the debtor's property or primarily to adjudicate private rights, then the exception is inapplicable.")

***6** Parkview argues that the CMS termination was not based on findings of a threat to the health or safety of patients. The premise of this argument is true, but largely irrelevant, as it is based on too circumscribed a view of the public interest. Our precedents distinguish between "actions enforcing generally applicable regulatory laws governing the behavior of debtors," which fall within the exception, and actions by "government agencies to enforce contractual rights against debtors," which do not. In re Corporacion de Servicios Medicos Hospitalarios de Fajardo, 805 F.2d 440, 445 (1st Cir. 1986). The question is whether CMS's termination enforces a generally applicable regulatory law or furthers a public policy interest beyond the contractual rights in the Provider Agreement.

[2] CMS has a strong public policy interest in seeing that Medicare-program dollars are not spent on institutions that fail to meet qualification standards. In this instance, the standards are those for "hospitals." See 42 U.S.C. § 1395*l*(t); 42 C.F.R. § 419. Reimbursing Parkview pursuant to the Provider Agreement after it had taken actions to disqualify itself from the Medicare program, rendering it unable to provide services required by that program, would have been a waste of public monies.[14] And unlike a dispute over a contractual agreement between the government and a single private party, such as the one at issue in In re Corporacion, applying the stay against CMS here would threaten CMS's ability to enforce generally the Medicare statute's carefully articulated regulatory structure. See In re Corporacion, 805 F.2d at 445–46 & n.5 (contrasting actions to enforce contractual rights with actions "to enforce specific provisions of general regulatory schemes," and noting that the government had not tried to revoke the debtor hospital's license until after filing an action to rescind its contract with the hospital, as well as the fact that the hospital had passed a "Medicare compliance inspection"). The termination here was plainly the exercise of a regulatory power provided in the Medicare statute. See 14 U.S.C. § 1395cc(b)(2)(B) (explaining that the Secretary may terminate a Provider Agreement when the provider "fails substantially to meet the applicable provisions of section 1395x of this title," which includes the statutory definition of "hospital").

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Further, it is clear that the termination of the Provider Agreement does not meet the pecuniary test. The government is not seeking recovery from Parkview, nor is it demanding any payment. Rather, one could reasonably view Parkview's petition as being made for the purpose of evading CMS's efforts to secure compliance with the Medicare statute—exactly the kind of action the police and regulatory power exception is meant to prevent. See In re McMullen, 386 F.3d at 324–25. Because CMS's termination of the Provider Agreement enforced the generally applicable framework of the Medicare statute and advanced a significant public policy interest, the police and regulatory power exception applies, and the automatic stay does not bar the termination.

***7** We do not reach the other arguments raised by the government as to the stay's application.

B. Non-Discrimination Provision

Parkview also argues that CMS's termination of the Provider Agreement violates the "non-discrimination" provision in 11 U.S.C. § 525(a), which states that:

> [A] governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, [or] discriminate with respect to such a grant against, ... a person that is or has been a debtor under this title.

11 U.S.C. § 525(a). Parkview argues that, because CMS's termination letter "came only two days after Parkview filed its chapter 11 petition and expressly stated that CMS's termination of the Provider Agreement followed CMS's review of court filings in this chapter 11 case," we should conclude that CMS terminated the Provider Agreement because of Parkview's insolvency.

[3] We see nothing in the termination decision that depended upon Parkview's insolvency or bankruptcy petition. CMS stated in its June 19 letter that it was terminating the Provider Agreement because Parkview had decided to close its inpatient facilities and thereby had ceased to qualify as a hospital under the Medicare statute. That termination decision involved no forbidden discrimination based on insolvency.

Parkview's argument that CMS discriminated against it, because CMS took notice of the filing of the bankruptcy petition in its termination decision, fails on its face. That CMS used information from that filing in considering the termination question is admirable and not discrimination.[15]

CMS's termination of the Provider Agreement is distinguishable from the cases Parkview cites in its favor. In In re Psychotherapy & Counseling Center, Inc., the Department of Health and Human Services ("HHS") attempted to exclude a mental health hospital from participation in Medicare and state health care programs after the hospital defaulted under a settlement plan with HHS and filed for chapter 11 bankruptcy. 195 B.R. 522, 524–27 (Bankr. D.D.C. 1996). The bankruptcy court rejected HHS's argument that the police and regulatory power exception applied and concluded that HHS's action violated § 525(a) because the record suggested that "HHS [was] seeking to exclude the debtor from a government program for non-payment of a dischargeable prepetition debt." Id. at 533. There is no basis for such an inference here. Quite the opposite—CMS has maintained throughout this litigation that its reason for terminating the Provider Agreement was Parkview's decision, announced in its June 15 letter, to disqualify itself as a hospital under the Medicare statute, and there is no evidence to the contrary.

***8** Similarly, in In re Sun Healthcare Group, Inc., the Health Care Financing Administration ("HCFA"), a division of HHS, refused to reinstate the subsidiary of a debtor corporation as a Medicare and Medicaid participant, even after the subsidiary had "met all compliance conditions and applied for reinstatement," because the subsidiary owed pre-petition debts to HCFA. No. 00–986–GMS, 2002 WL 2018868, at *1 (D. Del. Sept. 4, 2002). The district court affirmed the bankruptcy court's finding that HCFA's action had violated § 525(a) because, although the subsidiary had "provided reasonable assurance that its health services w[ould] meet HCFA regulations," it had discriminated against the debtor on account of its pre-petition debts. Id. at *7–8. Here, the termination had nothing to do with Parkview's pre-petition debts, and Parkview cannot assure CMS that Parkview will bring itself back into compliance with the Medicare statute. CMS's termination of the Provider Agreement was not impermissible discrimination.[16]

III.

The district court's denial of relief is affirmed.[17] Costs are **All Citations** awarded against Parkview.

--- F.3d ----, 2016 WL 6962086

Footnotes 1 At oral argument for this appeal, Parkview attempted to reframe the relief it sought. It claimed it was not seeking the continuation of any immediate payment, but rather the effective reinstatement of the Provider Agreement for the period from July 5, 2015 to August 20, 2015. Parkview conceded at oral argument that, despite its claim that it was not seeking immediate payment, the reinstatement of the Provider Agreement for the stated period would lead to reimbursement payments totaling several million dollars. Later at oral argument, Parkview characterized the relief it seeks somewhat differently—namely, as an annulment of CMS's termination letter.

2 Section 405(g) is made applicable to the Medicare statute via 42 U.S.C. § 1395ff(b)(1)(A).

3 Section 405(h) is made applicable to the Medicare statute via 42 U.S.C. § 1395ii.

4 We also acknowledge the amicus brief of Professor John Pottow. As Professor Pottow himself recognizes, his brief presents arguments on the jurisdictional question not advanced by the parties, and generally "an amicus cannot introduce a new argument into a case." United States v. Sturm, Ruger & Co., Inc., 84 F.3d 1, 6 (1st Cir. 1996).

5 See In re Bayou Shores SNF, LLC, 828 F.3d 1297, 1314 (11th Cir. 2016) (concluding that § 405(h)'s jurisdictional bar applies to 28 U.S.C. § 1344); Nichole Med. Equip. & Supply, Inc. v. TriCenturion, Inc., 694 F.3d 340, 346–47 (3d Cir. 2012) (concluding that § 405(h) "continues to bar virtually all grants of jurisdiction under Title 28," and holding specifically that it bars diversity jurisdiction under 28 U.S.C. § 1332); Midland Psychiatric Assocs., Inc. v. United States, 145 F.3d 1000, 1004 (8th Cir. 1998) (holding that § 405(h)'s jurisdictional bar applies to 28 U.S.C. § 1332); Bodimetric Health Servs., Inc. v. Aetna Life & Cas., 903 F.2d 480, 488–90 (7th Cir. 1990) (same).

6 Parkview argues that we already decided in In re Slater Health Center, Inc., 398 F.3d 98 (1st Cir. 2005), that § 405 does not bar bankruptcy jurisdiction. But Slater said nothing about this jurisdictional issue, and "[w]hen a potential jurisdictional defect is neither noted nor discussed in a federal decision, the decision does not stand for the proposition that no defect existed." Ariz. Christian Sch. Tuition Org. v. Winn, 563 U.S. 125, 131 S.Ct. 1436, 1448, 179 L.Ed.2d 523 (2011). Slater does not settle the question.

7 See also, e.g., Telles v. Lynch, 639 Fed.Appx. 658, 659 (1st Cir. 2016) (unpublished opinion) ("Because the petitioner's claims easily fail on the merits, we assume hypothetical jurisdiction."); Alvarado v. Holder, 743 F.3d 271, 276 (1st Cir. 2014) ("[U]nlike Article III jurisdiction, which we may never dodge, we may occasionally bypass statutory jurisdiction."); McBee v. Delica Co., Ltd., 417 F.3d 107, 127 (1st Cir. 2005) (discussing appropriateness of bypassing jurisdictional question where Article III jurisdiction is not in doubt and merits claim clearly fails).

8 This obviates the need to discuss the date of the termination.

9 The government argues that because "Parkview's plan of 'reorganization' was, from the outset intended to liquidate all its assets, there is a substantial question as to whether this case was properly filed under chapter 11 rather than chapter 7." The question is significant, the government suggests, because under chapter 7, an executory contract that is not assumed within sixty days of the commencement of the bankruptcy is deemed rejected, an action the government contends Parkview "never had any intention of taking and had no practical ability to complete after selling its inpatient hospital assets." See 11 U.S.C. § 365(d)(1). Because Parkview's legal arguments fail even if its chapter 11 petition was proper, we need not reach this argument.

10 On July 27, 2015, Parkview informed CMS that it considered CMS's termination an involuntary termination "because CMS based the effective date of termination on Parkview's failure to meet a requirement to be a hospital in the Medicare program" and sought to rescind its notice of voluntary termination.

11 On August 17, 2015, Parkview requested a hearing before an ALJ to dispute CMS's termination of the Provider Agreement. As already described above, the ALJ found, after briefing, that CMS had involuntarily terminated the Provider

Agreement and that it had had a legitimate basis to do so, because Parkview had permanently closed its inpatient services on June 18, 2015. Due to the notice requirements of the relevant regulations, the ALJ adjusted the effective date of the termination to July 4, 2015. The ALJ also rejected Parkview's argument for equitable estoppel because CMS had allegedly provided—through an employee of the Maine Department of Health and Human Services—false information to Parkview while Parkview was preparing its transition plan for bankruptcy.

12 "The Bankruptcy Code furnishes no express definition of an executory contract, see 11 U.S.C. § 365(a) (1982 ed.), but the legislative history of § 365(a) indicates that Congress intended the term to mean a contract 'on which performance remains due to some extent on both sides.' " N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 522 n.6, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984) (quoting H.R. Rep. No. 95-595, p. 347 (1977)).

13 Parkview also disputes the bankruptcy court's suggestion that CMS's termination of the Provider Agreement is exempt under 11 U.S.C. § 362(b)(28), which allows the Secretary of Health and Human Services to exclude debtors from participating in Medicare in certain circumstances. Because the police and regulatory power exception applies and because the government does not argue for the "exclusion" exception, we do not reach this issue.

14 Parkview does not concede that it ceased to be a hospital under the Medicare statute. But the substantive correctness of CMS's determination that Parkview ceased to be a hospital under the Medicare statute does not affect the analysis of whether the police and regulatory power exception to the stay applies to the decision, nor does it affect the analysis of whether the decision was discriminatory under § 525(a). In any event, Parkview in its briefing makes a point of not contesting any substantive issue of Medicare law, including whether its actions disqualified it as a "hospital" under the relevant provisions, and so the point is waived. United States v. Richardson, 225 F.3d 46, 52 n.2 (1st Cir. 2000) (explaining that issues raised for the first time at oral argument are waived).

15 Parkview claims that "CMS did not base its termination decision on any order of the Bankruptcy Court, any deficiency in the provision of services by Parkview, or any claimed breach of the provisions of the Provider Agreement itself." This assertion seems intended to suggest that CMS had no basis for its decision other than the fact of Parkview's filing for bankruptcy. CMS may not have based its decision on an order by the bankruptcy court, but it did consult Parkview's papers in the bankruptcy court to determine the termination date for the Provider Agreement. And CMS did base its termination decision on Parkview's decision to cease inpatient services, which is clearly a "deficiency in the provision of services" with respect to the Medicare statute, as well as a clear breach of the Provider Agreement.

16 As part of its discrimination argument, Parkview notes that CMS's termination decision led to the State of Maine's termination of Parkview's MaineCare Provider Agreement and that CMS's termination of the Medicare Provider Agreement will also terminate Parkview's Medicare Advantage Agreement and TriCare Agreement. These consequences of CMS's termination decision say nothing about the legal question of whether the decision was discriminatory under § 525(a).

17 To be clear, the government has represented that physicians at Parkview's remaining facilities may seek Medicare Part B reimbursement for non-hospital outpatient services.

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RULINGS BY SUMMARY ORDER DO NOT HAVE PRECEDENTIAL EFFECT. CITATION TO A SUMMARY ORDER FILED ON OR AFTER JANUARY 1, 2007, IS PERMITTED AND IS GOVERNED BY FEDERAL RULE OF APPELLATE PROCEDURE 32.1 AND THIS COURT'S LOCAL RULE 32.1.1. WHEN CITING A SUMMARY ORDER IN A DOCUMENT FILED WITH THIS COURT, A PARTY MUST CITE EITHER THE FEDERAL APPENDIX OR AN ELECTRONIC DATABASE (WITH THE NOTATION "SUMMARY ORDER"). A PARTY CITING A SUMMARY ORDER MUST SERVE A COPY OF IT ON ANY PARTY NOT REPRESENTED BY COUNSEL.
United States Court of Appeals,
Second Circuit.

In the Matter of: Fletcher International, Limited
Fletcher International, Limited Debtor.
Alphonse Fletcher, Jr., Appellant,
v.
Richard J. Davis, Appellee.

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November 3, 2016

Appeal from a judgment of the United States District Court for the Southern District of New York (Sullivan, *J.*).

***1 UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED** that the judgment of the district court is **AFFIRMED**.

Attorneys and Law Firms

FOR APPELLANT: Alphonse Fletcher, Jr., pro se, San Francisco, CA.

FOR APPELLEE: Michael Luskin, Lucia T. Chapman, Stephan E. Hornung, Luskin, Stern & Eisler LLP, New York, NY.

PRESENT: ROBERT A. KATZMANN, Chief Judge,
RALPH K. WINTER, RICHARD C. WESLEY, Circuit Judges.

SUMMARY ORDER

Appellant Alphonse Fletcher, Jr., proceeding pro se, appeals from the district court's judgment affirming an order of the bankruptcy court for the Southern District of New York, which denied Mr. Fletcher's motions to (1) vacate the appointment of the Chapter 11 trustee, Richard J. Davis (the "Trustee"), and the professionals he retained pursuant to 11 U.S.C. § 327(a), and (2) disgorge their fees and expenses. We assume the parties' familiarity with the underlying facts, the procedural history of the case, and the issues on appeal.

"A district court's order in a bankruptcy case is subject to plenary review, meaning that this Court undertakes an independent examination of the factual findings and legal conclusions of the bankruptcy court." *In re Cacioli*, 463 F.3d 229, 234 (2d Cir. 2006) (internal quotation marks omitted). Thus, we review the bankruptcy court's conclusions of law de novo and its findings of fact for clear error. *See In re First Cent. Fin. Corp.*, 377 F.3d 209, 212 (2d Cir. 2004). A bankruptcy court's denial of a motion to remove the trustee, however, and its decision regarding an award of compensation are reviewed for abuse of discretion. *See In re Eloise Curtis, Inc.*, 326 F.2d 698, 701 (2d Cir. 1964) (describing the election of a trustee "as an issue of discretion"); *In re Arlan's Dep't Stores, Inc.*, 615 F.2d 925, 943 (2d Cir. 1979) ("It is basic that we will not interfere with the district court's assessment of the compensation to be awarded attorneys in bankruptcy proceedings absent a clear abuse of discretion."). A bankruptcy court abuses its discretion when its ruling "(1) rests on an error of law ... or a clearly erroneous factual finding, or (2) cannot be located within the range of permissible decisions." *In re Smith*, 507 F.3d 64, 73 (2d Cir. 2007) (internal quotation marks and brackets omitted). "Bankruptcy judges' findings on conflict of interest questions are entitled to deference because a bankruptcy judge is on the front line, in the best position to gauge the ongoing interplay of factors and to make the delicate judgment calls which such a decision entails." *In re AroChem Corp.*, 176 F.3d 610, 628 (2d Cir. 1999) (internal quotation marks omitted).

We conclude first that the bankruptcy court did not abuse its discretion in denying Mr. Fletcher's motion on the ground that Mr. Fletcher had repeatedly failed to file proper papers

and comply with court orders in connection with his application. Mr. Fletcher did not timely object to the appointment of the Trustee or the professional firms he retained as his counsel and special consultant (Luskin, Stern & Eisler LLP and Goldin Associates, LLC, respectively (collectively, the "Retained Professionals")). Indeed, Mr. Fletcher raised his conflictof-interest allegations well over a year after the court approved those appointments and only after the Trustee filed a report finding that Mr. Fletcher had defrauded his investors and proposed a liquidation plan that deeply subordinated Mr. Fletcher's claims. Still, the bankruptcy court afforded Mr. Fletcher multiple opportunities to present his allegations in appropriate papers, culminating in the bankruptcy court's instruction at an April 2, 2014 conference to file a brief within 30 days specifying the relevant statutory provisions, the manner in which they had been allegedly violated, and the relief Mr. Fletcher sought. At the time the bankruptcy court entered its June 24, 2014 order denying Mr. Fletcher's motions, Mr. Fletcher had still not filed such a brief. The bankruptcy court was well within its discretion to deny Mr. Fletcher's motions for these reasons alone. *See In re Rafter Seven Ranches L.P.*, 414 B.R. 722, 739 (10th Cir. BAP 2009) ("A bankruptcy court's power to manage a case ... arises from the court's inherent authority to issue pretrial case management orders and to enforce them by appropriate measures." (internal quotation marks omitted)).

***2** Nor did the bankruptcy court abuse its discretion in determining that Mr. Fletcher's various filings did not give rise to any viable theory of conflict. Under 11 U.S.C. § 324(a), the bankruptcy court may, "remove a trustee ... for cause." 11 U.S.C. § 324(a). "Grounds for disapproval or removal of a trustee in bankruptcy are not to be found in his formal relationships," and, in assessing whether cause for removal exists, "[w]e have traditionally stressed the elements of fraud and actual injury to the debtor interests." *In re Freeport Italian Bakery, Inc.*, 340 F.2d 50, 54 (2d Cir. 1965) (internal quotation marks omitted).

The Trustee's alleged conflicts of interest were primarily based on professional relationships between the firm at which he was formerly a partner, Weil Gotshal & Manges LLP, and entities in some way affiliated with the defendants in an unrelated litigation brought by Mr. Fletcher involving his cooperative apartment building (the "Dakota Litigation"). However, the Trustee had retired from Weil Gotshal some nine months before he was appointed trustee, and Mr. Fletcher failed—and continues to fail—to explain how any such connection to the Dakota Litigation (to which the debtor is not a party) could render the Trustee or the Retained Professionals adverse to the estate. Mr. Fletcher's conclusory accusations of fraud and attenuated allegations of conflict are fundamentally insufficient to remove a Chapter 11 trustee. Nor does Mr. Fletcher plausibly allege actual injury to the debtor's interests. The bankruptcy court thus did not abuse its discretion in denying the motion to remove the Trustee.

With respect to Mr. Fletcher's efforts to vacate the appointments of the Retained Professionals based on their connections with various third parties, Mr. Fletcher's conclusory allegations failed to raise any presently held conflict with the debtor's estate. *See In re AroChem Corp.*, 176 F.3d at 623 ("[C]ounsel will be disqualified under section 327(a) only if it presently 'hold[s] or represent[s] an interest adverse to the estate,' notwithstanding any interests it may have held or represented in the past." (quoting 11 U.S.C. § 327(a))). Mr. Fletcher did not plausibly show how any of the third parties he points to are adverse to the estate, let alone how the Retained Professionals' relationships with those third parties render the Retained Professionals adverse to the estate. For that reason, even if Mr. Fletcher were correct that the Trustee and the Retained Professionals should have disclosed certain connections pursuant to Federal Rule of Bankruptcy Procedure 2014, the bankruptcy court did not abuse its discretion in denying Mr. Fletcher's motions. *See* Fed. R. Bankr. P. 2014(a) (requiring the disclosure "to the best of the applicant's knowledge" of "all of the [professional] person's connections with the debtor, creditors, any other party in interest, [and] their respective attorneys and accountants"). In any event, the Retained Professionals disclosed in their retention applications the majority of the relationships at issue, and Mr. Fletcher failed to timely object.

For the same reasons, the bankruptcy court did not abuse its discretion in denying Mr. Fletcher's request that it disgorge the Trustee's and the Retained Professionals' compensation or in declining to hold an evidentiary hearing.

We have considered Mr. Fletcher's remaining arguments **All Citations** and find them to be without merit. Accordingly, we

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AFFIRM the judgment of the district court.

--- Fed.Appx. ----, 2016 WL 6536372

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issued on or after Jan. 1, 2007. See also U.S.Ct. of
Appeals 3rd Cir. App. I, IOP 5.1, 5.3, and 5.7.
United States Court of Appeals, Third
Circuit.

In re: David J. Aiello, Debtor
Maria A. Aiello
v.
David J. Aiello, Appellant

No.
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1502
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Submitted Pursuant to Third Circuit
L.A.R. 34.1(a) November 1, 2016
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(Filed: November 28, 2016)

Synopsis

Background: Widow who had obtained state court judgment against Chapter 7 debtor for his breach of fiduciary duties that he owed as executor of her late husband's probate estate brought adversary proceeding to except judgment debt from discharge on "fiduciary fraud or defalcation" or "willful and malicious injury" theory, and moved for summary judgment based on preclusive effect of prior state court judgment. The United States Bankruptcy Court for the District of Western Pennsylvania, Jeffery A. Deller, Chief Judge, 533 B.R. 489, granted widow's motion, and debtor appealed. The District Court, Kim R. Gibson, J., 550 B.R. 83, affirmed. Debtor appealed.

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

[1] state court's findings were entitled to preclusiveeffect, in subsequent nondischargeability proceeding, as to debtor's status as fiduciary and wrongful conduct in that capacity, and

[2] fiduciary breaches were sufficiently widespread tosupport inference that debtor had acted with culpable mental state, and prevented discharge of resulting debt as one for debtor's "fraud or defalcation while acting in fiduciary capacity." Affirmed.

West Headnotes (2)

[1] **Bankruptcy**

Fiduciaries and Fiduciary Capacity

Judgment

Bankruptcy

While state court, in surcharging debtor for his multiple breaches of fiduciary duty while acting as executor of his late brother's probate estate, did not have to find that debtor acted with guilty state of mind, as required to except resulting debt from discharge on "fiduciary fraud or defalcation" theory, this did not detract from issue preclusive effect of state court's findings, in subsequent nondischargeability proceeding, as to debtor's status as fiduciary and wrongful conduct in that capacity, two of the same issues presented in nondischargeability proceeding. 11 U.S.C.A. § 523(a)(4).

Cases that cite this headnote

[2] **Bankruptcy**

Defalcation; l arceny; e mbezzlement

Determination that debtor, in his capacity as executor of his late brother's probate estate, had sold estate's stock in cable television company to himself and third party for promissory note in amount that was half of stock's value, had purchased other stock owned by estate without making any effort to market it, had invested $50,000 of estate funds in business in which he had interest, and had conveyed estate's interest in three pieces of real property for no value, concerned fiduciary breaches and acts of self-dealing that were sufficiently widespread to

support inference that debtor had acted with culpable mental state, and prevented discharge of resulting debt as one for debtor's "fraud or defalcation while acting in fiduciary capacity." 11 U.S.C.A. § 523(a)(4).

Cases that cite this headnote

On Appeal from the District Court for the Western District of Pennsylvania, (D.C. Civil No. 3–15–cv–00193), District Judge: Honorable Kim R. Gibson

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Before: HARDIMAN, SCIRICA, Circuit Judges, and

ROSENTHAL,[*] District Judge

OPINION[**]

SCIRICA, Circuit Judge

***1** The United States Bankruptcy Court for the Western District of Pennsylvania granted Appellee Maria Aiello's Motion for Summary Judgment, finding the debt owed to her by Appellant David J. Aiello was nondischargeable in bankruptcy under 11 U.S.C. § 523(a)(4). The District Court affirmed the Bankruptcy Court order, and Mr.

Aiello appeals.[1] We will affirm.

I.

Maria Aiello was married to David Aiello's brother. When Ms. Aiello's husband passed away in 1977, Ms. Aiello renounced her appointment as executor of his estate, and David Aiello stepped in to serve as executor. Ms. Aiello later filed a petition seeking an accounting of Mr. Aiello's administration of the estate, and in 2001, filed exceptions to the accounting in the Court of Common Pleas of Elk County, Orphans' Court Division ("Orphans' Court"). Ms. Aiello alleged Mr. Aiello had engaged in self-dealing and breached his fiduciary duty.

The Orphans' Court held an evidentiary hearing over the course of several days, after which it issued its Findings of Fact, Conclusions of Law and Opinion. The Orphans' Court found:

- Mr. Aiello redeemed 100 shares of the estate's interestin Ridgway Cable Television, Inc. for a $200,000 note after the shares had been valued at $400,000 and shortly before the company was sold for $1.5 million. Mr. Aiello and another brother, Victor, were the only two remaining shareholders. The Orphans' Court imposed a $300,000 surcharge against Mr. Aiello for self-dealing.

- Mr. Aiello purchased 125.5 of the estate's shares ofstock in St. Mary's Pressed Metals, Inc. ("SMPM") without making an effort to market the estate's shares publicly or privately. Other shares of the estate's stock were purchased by a group of individuals that included Mr. Aiello and the attorney he hired to represent the estate. The Orphans' Court described Mr. Aiello's actions in connection with the sale and purchase of the shares of SMPM stock as "blatant acts of self-dealing" and voided the transfer of the estate's shares of stock. J.A. 125.

- Mr. Aiello loaned $250,000 of the estate's funds toSMPM without disclosing the loan to Ms. Aiello. Mr. Aiello subsequently forgave the balance of the loan. Mr. Aiello was also a creditor of SMPM, but he did not forgive any obligation owed to him by SMPM. The Orphans' Court found Mr. Aiello offered "no reasonable or rational explanation" for forgiving the balance due to the estate and imposed a surcharge of $49,268.12, equal to the balance of the loan. J.A. 116.

- Mr. Aiello failed to have a stock certificate issued forthe estate's remaining 18 shares of SMPM stock. The Orphans' Court found Mr. Aiello "ha[d] not fulfilled his duties as the Estate executor" in connection with those shares. J.A. 116.

- Mr. Aiello encouraged Ms. Aiello to invest estatefunds in Salberg Auto Wreckers, of which Mr.

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Aiello owned 50%. At his urging, Ms. Aiello invested $50,000 of the estate's funds in the business. Ms. Aiello never received any income or return on her investment, and when the business was sold, Ms. Aiello received only $31,571.75 from the sale proceeds. The Orphans' Court imposed a surcharge for the $18,428.35 loss based on Mr. Aiello's selfdealing.

***2** • The estate held interests in three pieces of real property. Mr. Aiello conveyed the estate's interest in each of the three properties: one to himself, one to his brother, Victor, and one to Victor's family trust. The estate's interest in each of the three properties was conveyed without consideration. The Orphans' Court found Mr. Aiello "unequivocally violated his fiduciary duty with regard to these conveyances." J.A. 129. It voided Mr. Aiello's interest in the property he conveyed to himself and imposed a constructive trust for Ms. Aiello's benefit.

- The Orphans' Court found Mr. Aiello "failed entirelyto keep and protect the Estate records and to properly administer the Estate, which he treated as a clearinghouse for his own transactions and enterprises." J.A. 113. The Orphans' Court added, Mr. Aiello "failed in the performance of his fiduciary duties by not exercising the assiduity, caution, acumen and expertise that a prudent or reasonable person would ordinarily utilize in the management of their own affairs." J.A. 113. It imposed a surcharge of $25,000 for Mr. Aiello's failure to act in the best interest of the estate and its beneficiaries.

Mr. Aiello appealed, and the Superior Court of Pennsylvania affirmed the decision of the Orphans' Court.

In 2010, judgment was entered against Mr. Aiello in the amount of $1,021,723.34, based upon the surcharges, with interest, imposed by the Orphans' Court. Mr. Aiello filed a Chapter 7 bankruptcy petition in the United States Bankruptcy Court for the Western District of Pennsylvania in 2012. In 2014, Ms. Aiello filed a complaint to determine dischargeability in Mr. Aiello's bankruptcy proceeding. She subsequently moved for summary judgment, contending the judgment arising from the Orphans' Court decision was nondischargeable and the doctrine of collateral estoppel precluded Mr. Aiello from relitigating issues previously decided by the Orphans' Court and the Superior Court.

The Bankruptcy Court granted Ms. Aiello's motion and found the debt nondischargeable because it arose from "fraud or defalcation while acting in a fiduciary capacity." 11 U.S.C. § 523(a)(4). It applied the doctrine of collateral estoppel to the findings of the state courts regarding Mr. Aiello's conduct and found the record sufficient to establish as a matter of law that Mr. Aiello had the requisite scienter for defalcation.

Mr. Aiello appealed the Bankruptcy Court's decision to the District Court, and the District Court affirmed the Bankruptcy Court's order in its Memorandum Opinion and Order dated February 17, 2016. This appeal followed.

II.[2]

Mr. Aiello's primary argument is that the Bankruptcy Court erred in its application of the doctrine of collateral estoppel. Mr. Aiello contends the Orphans' Court was not required to, and indeed did not, make any findings with regard to Mr. Aiello's state of mind when it entered judgment against him for self-dealing and breach of fiduciary duty.[3] The absence of any finding regarding his state of mind, Mr. Aiello contends, precludes the application of the doctrine of collateral estoppel because the United States Supreme Court has held defalcation requires "an intentional wrong." *Bullock v. BankChampaign, N.A.*, ––– U.S. ––––, 133 S.Ct. 1754, 1759, 185 L.Ed.2d 922 (2013). Mr. Aiello contends his state of mind remains in dispute, and summary judgment was improperly granted.

***3 [1]** Determination of whether an exception to discharge applies is the province of federal bankruptcy courts. *Grogan v. Garner*, 498 U.S. 279, 284 n.10, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). Although state courts may not determine dischargeability of a debt, the principles of collateral estoppel may be applied to discharge exception proceedings to prevent relitigation of relevant issues that have previously been adjudicated by state courts. *Id.* at 284 n.11, 111 S.Ct. 654. Here, the Bankruptcy Court correctly applied the principles of issue preclusion under Pennsylvania law.[4] The Bankruptcy Court's determination of whether Ms. Aiello's judgment against Mr. Aiello could be discharged turned on whether the judgment arose from "fraud or defalcation while acting in a fiduciary capacity." 11 U.S.C. § 523(a)(4). The Orphans'

Court and Superior Court had conclusively resolved key issues underlying that determination, including Mr. Aiello's status as a fiduciary and the wrongfulness of his conduct while acting in that capacity. Those issues were essential to the state court's judgment, and the Bankruptcy Court was obligated to address those identical issues to determine dischargeability. Accordingly, the Bankruptcy Court correctly applied the doctrine of collateral estoppel and found Mr. Aiello could not contest the Orphans' Court findings regarding his conduct. The Bankruptcy Court's dischargeability determination *also* requires a finding regarding Mr. Aiello's state of mind, *see* *Bullock*, 133 S.Ct. at 1759–60, but that does not diminish the preclusive effect of the state court's findings regarding Mr. Aiello's conduct while acting as a fiduciary.

[2] Summary judgment in favor of Ms. Aiello was also correctly granted by the Bankruptcy Court. Summary judgment is appropriate "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). A dispute is genuine only if there is sufficient evidentiary basis on which a reasonable trier of fact could return a verdict for the non-moving party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986).

Under *Bullock*, defalcation encompasses "conduct that the fiduciary knows is improper [and] reckless conduct of the kind that the criminal law often treats as the equivalent." 133 S.Ct. at 1759. It includes a fiduciary's conscious disregard of " 'a substantial and unjustifiable risk' that his conduct will turn out to violate a fiduciary duty." *Id.* (quoting ALI, Model Penal Code § 2.02(2) (c) (1985)). "That risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves *a gross deviation* from the standard of conduct that a law-abiding person would observe in the actor's situation." *Id.* at 1760 (internal quotation marks omitted).

The state court's findings are conclusive on Mr. Aiello's wrongful conduct; accordingly, the only remaining issue in dispute was whether Mr. Aiello knew his conduct was unlawful or consciously disregarded a substantial risk that his conduct violated his fiduciary duty. The Bankruptcy Court correctly concluded no reasonable trier of fact could find that Mr. Aiello did not act in violation of his fiduciary duty with the state of mind required by *Bullock*.

Intent "must be gleaned from inferences drawn from a course of conduct." *Rosen v. Bezner*, 996 F.2d 1527, 1534 (3d Cir. 1993) (quoting *In re Kauffman*, 675 F.2d 127, 128 (7th Cir. 1981)). Many courts have concluded that undisputed evidence of egregious fiduciary violations may be used at summary judgment to find that a debtor was reckless as to the impropriety of his actions. *See, e.g.*, *In re Heers*, 529 B.R. 734 (9th Cir. BAP 2015) (looking to the undisputed facts in the record—a pervasive and unjustified series of breaches of fiduciary duties—to find recklessness at the summary judgment stage); *Stoughton Lumber Co. v. Sveum*, 787 F.3d 1174, 1177 (7th Cir. 2015) (similarly inferring recklessness based on cumulative facts).

***4** Mr. Aiello's course of conduct provides sufficient circumstantial evidence of intent to conclude as a matter of law that he knew his conduct was unlawful.[5] Mr. Aiello engaged in several transactions that benefited himself and his brother Victor to the clear detriment of the estate. He sold the estate's shares of Ridgway Cable Television to himself and his brother for half their value. He sold the estate's shares of SMPM stock to himself and his business associates at prices he set. He conveyed three separate pieces of real property to himself and his brother without consideration. He urged Ms. Aiello to invest estate funds in his own ill-fated business, and he forgave the balance of a substantial loan from the estate without any rational explanation. Mr. Aiello's efforts to conceal his self-dealing transactions provide further circumstantial evidence of intent. Mr. Aiello failed to keep estate records, failed to keep Ms. Aiello informed about his management of the estate, and failed to seek court approval for transactions that required it. Mr. Aiello's repeated and blatant selfdealing and his efforts to conceal it constitute a gross deviation from the standard of conduct that a lawabiding person would observe. Summary judgment was appropriate, and the judgment against Mr. Aiello is not dischargeable.

III.

For the foregoing reasons, we will affirm the District Court's order entered on February 17, 2016, which affirmed the order of the Bankruptcy Court.

All Citations

--- Fed.Appx. ----, 2016 WL 6933939

Footnotes

* The Honorable Lee H. Rosenthal, United States District Judge for the Southern District of Texas, sitting by designation

** This disposition is not an opinion of the full Court and pursuant to I.O.P. 5.7 does not constitute binding precedent.

1 The Bankruptcy Court had jurisdiction pursuant to a Chapter 7 bankruptcy filed on September 6, 2012. The District Court had jurisdiction over the appeal from the Bankruptcy Court's order under 28 U.S.C. § 158(a). We have jurisdiction under 28 U.S.C. § 158(d)(1).

2 In reviewing orders of the Bankruptcy Court, we review factual findings for clear error and exercise plenary review over questions of law. *In re Graves*, 33 F.3d 242, 246 (3d Cir. 1994). "[O]ur review duplicates that of the district court and we view the bankruptcy court decision unfettered by the district court's determinations." *In re Brown*, 951 F.2d 564, 567 (3d Cir. 1991).

3 Pennsylvania law does not require a showing of bad faith or fraudulent intent on the part of the fiduciary where selfdealing is apparent from the circumstances. *In re Dobson's Estate*, 490 Pa. 476, 417 A.2d 138, 142 n.6 (1980).

4 Where the preclusive effect of a state court judgment is at issue, the federal court must apply state preclusion principles to determine the extent to which the state court judgment bars relitigation of the issues. *Marrese v. Am. Acad. of Orthopaedic Surgeons*, 470 U.S. 373, 381–82, 105 S.Ct. 1327, 84 L.Ed.2d 274 (1985). Under Pennsylvania law, an issue previously decided cannot be relitigated when: (1) the issue decided in the prior case is identical to the one presented in the later action; (2) there was a final adjudication on the merits; (3) the parties in the later proceeding are identical or in privity to those in the earlier proceeding; (4) the party seeking to relitigate the issue decided had a full and fair opportunity to litigate the issue in the prior proceeding; and (5) the determination in the prior proceeding was essential to the judgment. *Metro. Edison Co. v. Pa. Pub. Util. Comm'n*, 767 F.3d 335, 351 (3d Cir. 2014); *Office of Disciplinary Counsel v. Kiesewetter*, 585 Pa. 477, 889 A.2d 47, 50–51 (2005). There is no dispute between the parties that the second, third, and fourth elements are satisfied.

5 Alternatively, there is sufficient evidence to conclude he was at least reckless as to the impropriety of his conduct, which is sufficient under *Bullock*. 133 S.Ct. at 1759 (defining defalcation to include "reckless conduct of the kind that the criminal law often treats as the equivalent" of knowing conduct).

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2016 WL 6803710
United States Court of Appeals,
Third Circuit.

In re: Energy Future Holdings Corp., a/k/a TXU Corp. a/k/a TXU Corp a/k/a/ Texas Utilities, et al., Debtors
Delaware Trust Company, f/k/a CSC Trust Company of Delaware, as Indenture Trustee, Appellant
v.
Energy Future Intermediate Holding Company LLC; EFIH Finance Inc.; Ad Hoc Committee of EFIH Unsecured Noteholders
In re: Energy Future Holdings Corp., a/k/a TXU Corp. a/k/a TXU Corp a/k/a Texas Utilities, et al., Debtors
Computer Trust Company, NA & Computershare Trust Company of Canada, Appellants
v. Energy Future Intermediate Holding Company LLC; EFIH Finance Inc.

No.
16
-
1351
|
Nos. 16-1926, 16-1927 & 16-1928
|
Argued September 27, 2016
|
(Opinion filed November 17, 2016)

Synopsis

Background: Indenture trustee objected to motion by Chapter 11 debtor for leave to obtain debtor-in-possession financing to pay off notes that had been accelerated upon its bankruptcy filing, on ground that noteholders were entitled to early redemption premium. The United States Bankruptcy Court for the District of Delaware, Christopher S. Sontchi, J., 527 B.R. 178, concluded that noteholders were not entitled to premium, and later denied motion for relief from stay to decelerate notes, 533 B.R. 106, and reached same conclusion with regard to second lien noteholders right to early redemption premium, 539 B.R. 723. Indenture trustee appealed, and the District Court, Richard G. Andrews, J., 2016 WL 1451045 and 2016 WL 627343, affirmed. Indenture trustee appealed.

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

[1] "redemption," of kind required to trigger debtor-borrower's obligation for early redemption premium, could include both pre- and post-maturity repayments of note;

[2] debtor-borrower's redemption of notes that had beenaccelerated automatically as result of its bankruptcy filing, over objection of noteholders that did not want to be repaid early, but that had been blocked by automatic stay from decelerating the notes, had to be regarded as "voluntary";

[3] redemption, coming before date specified in parties'agreement, triggered debtor's obligation for early redemption premium; and

[4] mere fact that promissory notes had been automaticallyaccelerated as result of debtor-borrower's Chapter 11 filing, pursuant to one provision of trust indenture, did not render another provision requiring payment of early redemption premium inapplicable.

Reversed and remanded.

West Headnotes (20)

[1] Bankruptcy
Conclusions of law; d e novo review

Bankruptcy court's determinations on questions of statutory construction and contract interpretation are legal determinations reviewable de novo.

Cases that cite this headnote

[2] Federal Courts
Highest court
Federal Courts
Anticipating or predicting state decision

When interpreting state law, federal court must follow the state's highest court, and if state's highest court has not provided guidance, federal court is

charged with predicting how that court would resolve the issue.

Cases that cite this headnote

[3] **Federal Courts**

Highest court

Federal Courts

Inferior courts

Federal Courts

Sources of authority; a ssumptions permissible

To predict how state's highest court would resolve an unsettled question of state law, federal court must take into consideration:
(1) what that court has said in related areas; (2) the decisional law of state's intermediate courts; (3) federal cases interpreting state law; and (4) decisions from other jurisdictions that have discussed the issue.

Cases that cite this headnote

[4] **Contracts**

Intention of Parties

Under New York law, fundamental, neutral precept of contract interpretation is that agreements are construed in accordance with parties' intent.

Cases that cite this headnote

[5] **Contracts**

Language of contract

Under New York law, best evidence of what parties to written agreement intend is what they say in their writing.

Cases that cite this headnote

[6] **Contracts**

Application to Contracts in General

Contracts

Rewriting, remaking, or revising contract

Under New York law, it is role of courts to enforce agreement made by the parties, not to add, excise or distort the meaning of terms that they chose to include, thereby creating a new contract under the guise of construction.

Cases that cite this headnote

[7] **Contracts**

Rewriting, remaking, or revising contract

Contracts

Language of contract

Under New York law, adherence to traditional principles of contract construction, that best evidence of what parties to written agreement intend is what they say in their writing, and that court may not add to, excise or distort the meaning of the terms that parties chose to employ under the guise of contract construction, is particularly appropriate when interpreting documents drafted by sophisticated, counseled parties, that involve the loan of substantial sums of money.

Cases that cite this headnote

[8] **Bills and Notes**

Mode and Sufficiency of Payment

Under New York law, "redemption," of kind required to trigger borrower's obligation for early redemption premium, may include both pre- and post-maturity repayments of note.

Cases that cite this headnote

[9] **Bills and Notes**

Mode and Sufficiency of Payment

Chapter 11 debtor-borrower's redemption of notes that had been accelerated automatically as result of its bankruptcy filing, over objection of noteholders that did not want to be repaid early, but that had been blocked by automatic stay from decelerating the notes, had to be regarded as "voluntary," as required to trigger debtor-borrower's obligation for early redemption premium, where debtor had the option, pursuant to its reorganization plan, to reinstate the accelerated notes' original maturity date but chose not to do so, and had in fact filed for bankruptcy

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in attempt to repay notes early while avoiding obligation for early redemption premium.

Cases that cite this headnote

[10] **Bills and Notes**

Mode and Sufficiency of Payment

Chapter 11 debtor-borrower's voluntary redemption of notes that had been accelerated automatically as result of its bankruptcy filing was in nature of early redemption, of kind triggering its obligation for early redemption premium; while redemption occurred after notes had matured as result of being automatically accelerated, it occurred prior to due date specified in agreement between parties.

Cases that cite this headnote

[11] **Bills and Notes**

Mode and Sufficiency of Payment

Mere fact that promissory notes had been automatically accelerated as result of debtorborrower's Chapter 11 filing, pursuant to one provision of trust indenture, did not render another provision requiring payment of early redemption premium inapplicable; provisions had to be construed together in order to give effect to both.

Cases that cite this headnote

[12] **Contracts**

Construction as a whole

Under New York law, contracts are to be interpreted to avoid inconsistencies and to give meaning to all of their terms.

Cases that cite this headnote

[13] **Bills and Notes**

Mode and Sufficiency of Payment

Language in second lien trust indenture, providing that, upon acceleration of notes, it was not only the principal, but "premium, if any," that would become immediately due and payable, was most naturally interpreted as referring to early redemption premium, the only "premium" referred to in trust indenture, and clarified that lender was entitled to this early redemption premium even after notes had been accelerated, without need for any greater level of exactness by parties.

Cases that cite this headnote

[14] **Bills and Notes**

Time of Maturity

Bills and Notes

Mode and Sufficiency of Payment

Under New York law, while agreement must clearly provide for payment of prepayment penalty even after note has been accelerated, in order for lender to obtain such a premium in connection with borrower's payment of accelerated note, that is not the rule with regard to yield-protection payments not styled as prepayment premiums; rather, if borrowers want their contractual obligation for yield protection payment not tied to any "prepayment" to terminate upon acceleration of debt, they must make that intent clear.

Cases that cite this headnote

[15] **Federal Courts**

State Courts and Their Decisions in General

In interpreting laws of state, federal court need not follow the judgments of its trial courts.

Cases that cite this headnote

[16] **Bills and Notes**

Time of Maturity

Under New York law, while acceleration advances the maturity date of debt, other terms of contract that are not necessarily impacted by acceleration do not automatically cease to be enforceable after acceleration.

Cases that cite this headnote

[17] **Bills and Notes**

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Time of Maturity

Bills and Notes

Mode and Sufficiency of Payment

Acceleration, by definition, advances the maturity date of debt, so that any payment thereafter is not prepayment, but is instead payment made after maturity; after maturity, any option to prepay can no longer be exercised.

Cases that cite this headnote

[18] Bills and Notes

Mode and Sufficiency of Payment

Unlike prepayment, redemption of debt security may occur at or before maturity.

Cases that cite this headnote

[19] Bills and Notes

Mode and Sufficiency of Payment

Under New York law, while a premium contingent on "prepayment" cannot take effect after a debt's maturity, a premium tied to a "redemption" is unaffected by acceleration of debt's maturity.

Cases that cite this headnote

[20] Contracts

Application to Contracts in General

In interpreting contract under New York law, court must give effect to the words and phrases that the parties chose.

Cases that cite this headnote

Appeal from the United States District Court for the District of Delaware (D.C. Civil Action Nos. 1–15– cv–00620, 1–15–cv–01011, 1–15–cv–01014 & 1–15–cv– 01015), District Judge: Honorable Richard G. Andrews **Attorneys and Law Firms**

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Before: AMBRO, SMITH,* and FISHER, Circuit Judges

OPINION OF THE COURT

Ambro, Circuit Judge

***1** We address what happens when one provision of an indenture for money loaned provides that the debt is

accelerated if the debtor files for bankruptcy and while in bankruptcy it opts to redeem that debt when another indenture provision provides for a redemption premium. Does the premium, meant to give the lenders the interest yield they expect, fall away because the full principal amount is now due and the noteholders are barred from rescinding the acceleration of debt? We hold no.

I. BACKGROUND

A. The Notes

Energy Future Intermediate Holding Company LLC and EFIH Finance Inc. (collectively, "EFIH") borrowed in 2010 approximately $4 billion at a 10% interest rate by issuing Notes due in 2020 and secured by a first-priority lien on their assets (the "First Lien Notes"). To protect (at least in part) the lenders' anticipated interest-rate yield, the Indenture governing the loan (the "First Lien Indenture") provides in § 3.07, captioned "Optional Redemption," that "[a]t any time prior to December 1, 2015, [EFIH] may redeem all or a part of the Notes at a redemption price equal to 100% of the principal amount of the Notes redeemed plus the Applicable Premium ... and accrued and unpaid interest" (emphasis in original). "Applicable Premium" is what we shall call the make-whole, or yieldprotection, contractual substitute for interest lost on Notes redeemed before their expected due date.

The First Lien Indenture contains an acceleration provision in § 6.02 that makes "all outstanding Notes ... due and payable immediately" if EFIH files a bankruptcy petition. The same provision also gives the First Lien Noteholders the right to "rescind any acceleration [of] the Notes and its consequences[.]"

EFIH borrowed funds again in 2011 and 2012 by issuing two sets of Notes secured by a second-priority lien on its assets (the "Second Lien Notes"). As with the First Lien Noteholders, EFIH promised to pay holders of the Second Lien Notes (the "Second Lien Noteholders") a make-whole premium—in a provision essentially identical to the one quoted above—if it chose to redeem the Second Lien Notes, at its option, on or before a date certain (May 15, 2016 for Second Lien Notes set to mature in 2021 and March 1, 2017 for those maturing in 2022).

The Indenture for the Second Lien Notes (the "Second Lien Indenture") contains an acceleration provision different from § 6.02 of the First Lien Indenture: if EFIH files a bankruptcy petition, "all principal of *and premium, if any*, interest ...[,] and *any other monetary obligations* on the outstanding Notes shall be due and payable immediately[.]" Second Lien Indenture § 6.02 (emphases added). Like the First Lien Noteholders, the Second Lien Noteholders have the right to "rescind any acceleration [of] the Notes and its consequences" under §
6.02.

B. Refinancing the First Lien Notes

When market interest rates went down, EFIH considered refinancing the Notes. Refinancing outside of bankruptcy would have required it to pay the make-whole premium. *See* *In re Energy Future Holdings Corp.*, 527 B.R. 178, 188 (Bankr. D. Del. 2015). By filing for bankruptcy, however, EFIH believed it might avoid the premium. So on November 1, 2013, it filed an 8–K form with the Securities and Exchange Commission "disclosing [its] proposal [whereby] ... EFIH would file for bankruptcy and refinance the Notes without paying any make-whole amount." *Id.* (internal quotation marks omitted).

***2** Six months later, on April 29, 2014, EFIH and other members of its corporate family filed Chapter 11 bankruptcy petitions in the Bankruptcy Court for the District of Delaware. Once in bankruptcy, EFIH sought to "take advantage of highly favorable debt market conditions to refinance," beginning with the First Lien Notes. *Id.* at 189. It asked the Bankruptcy Court for leave to borrow funds to pay them off and to offer a settlement to any of its First Lien Noteholders who agreed to waive their right to the make-whole. *Id.* at 182, 189.

Fearing loss of the income stream EFIH had promised, the Trustee for the First Lien Noteholders—Delaware Trust Company—filed an adversary proceeding on May 15, 2014. It sought a declaration that refinancing the First Lien Notes would trigger the make-whole premium.

EFIH's bankruptcy filing caused the "[First Lien] Notes [to] be[come] due and payable immediately" under Indenture § 6.02, subject to the right of their holders to rescind acceleration. So the Trustee also requested a declaration that it could rescind the First Lien Notes' acceleration without violating the automatic stay of creditors' acts to enforce their remedies once bankruptcy occurs, 11 U.S.C. § 362. However, should the stay apply, the Trustee asked the Court to lift it.

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When the Bankruptcy Court did not act, on June 4, 2014, the holders of a majority of the principal amount of the First Lien Notes sent a notice to EFIH rescinding acceleration, contingent on relief from the automatic stay. Two days later, the Bankruptcy Court granted EFIH's motion to refinance. It ruled, however, that the refinancing would not prejudice the First Lien Noteholders' rights in the pending adversary proceeding.

On June 19, 2014, EFIH paid off the First Lien Notes and refinanced the debt at a much lower interest rate of 4.25%, saving "an estimated $13 million in interest per month." *In re Energy Future Holdings Corp.*, 527 B.R. at 189. This of course disadvantaged the First Lien Noteholders, who had contracted to receive interest at 10% until the Notes' full maturity in 2020. EFIH did not compensate the loss set by contract by paying the make-whole, which would have been approximately $431 million.

C. Refinancing the Second Lien Notes

Shortly after entering bankruptcy, EFIH declared in an SEC 8–K filing that it "reserve[d] the right to ... redeem ... some or all of the outstanding ... Second Lien Notes" but asserted that it "[wa]s under no obligation to do so." *See In Re Energy Future Holdings Corp.*, No. 14–50363 (Bankr. D. Del.), Docket Entry 181, A–222. Aware of this, as well as the First Lien Noteholders' predicament, the Trustees for the Second Lien Noteholders—Computershare Trust Company, N.A. and Computershare Trust Company of Canada—filed their own adversary proceeding on June 16, 2014.

Like the First Lien Trustee, the Second Lien Trustees sought a declaration that EFIH would have to pay the make-whole if it chose to refinance the Second Lien Notes. The Second Lien Noteholders also issued a notice rescinding acceleration of that debt and requested retroactive relief from the automatic stay so that the rescission could take effect.

With the Bankruptcy Court's permission, EFIH refinanced a portion of the Second Lien Notes on March 10, 2015—again without paying the yield-protection amount.

D. First Lien Make–Whole Litigation

Nine months after granting leave to refinance the First Lien Notes, the Bankruptcy Court considered whether EFIH had to pay the make-whole. *In re Energy Future Holdings Corp.*, 527 B.R. at 191–95. The holding was that it did not. *Id.*

***3** Although EFIH's obligation to pay the make-whole appears in § 3.07 of the First Lien Indenture, the Court focused its reasoning on the acceleration provision in § 6.02. Because it took effect when EFIH entered bankruptcy but made no mention of the make-whole, the Court concluded that none was due.[1]

It further held that the automatic stay prevented the First Lien Noteholders' attempt to rescind the Notes' acceleration. *Id.* at 197. Finally, after trial in 2015, it denied the Trustee's motion to lift the stay retroactively "to a date on or before June 19, 2014, to allow the Trustee to ... decelerate the Notes." *In re Energy Future Holdings Corp.,* 533 B.R. 106, 116 (Bankr. D. Del. 2015).

These rulings put the First Lien Noteholders in a Catch– 22. When EFIH filed for bankruptcy, the maturity of its debt accelerated. This, according to the Bankruptcy Court, cut off the First Lien Noteholders' right to yieldprotection. Rescission of the acceleration would have restored that right. But rescission was blocked by the automatic stay, which the Court refused to lift.

The District Court for the District of Delaware affirmed the Bankruptcy Court's rulings in February 2016. *In re Energy Future Holdings Corp.*, No. CV 15–620 RGA, 2016 WL 627343, at *1–3 (D. Del. Feb. 16, 2016).

E. Second Lien Make–Whole Litigation The Second Lien Noteholders fared no better than the First Lien Noteholders. Six months after EFIH refinanced a portion of the Second Lien Notes, the Court considered the Second Lien Noteholders' entitlement to the make-whole. In construing the Second Lien Indenture's provisions, the Court adopted its findings and conclusions from the make-whole litigation for the First Lien Noteholders. After rejecting arguments based on the few differences between the First and Second Lien Indentures' texts, the Court held that the Second Lien Noteholders also were not entitled to yield-protection. *In re Energy Future Holdings Corp.*, 539 B.R. 723, 733 (Bankr. D. Del. 2015). The District Court again affirmed. *In re: Energy Future Holdings Corp.*, No. CV 15–1011– RGA, 2016 WL 1451045, at *4 (D. Del. Apr. 12, 2016).

* * * * *

The First and Second Lien Trustees brought appeals on behalf of their respective Noteholders, which we

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consolidated. They argue the Bankruptcy and District Courts erred by holding that the Indentures did not require payment of the make-whole when EFIH redeemed the Notes after their maturity had accelerated.

(2011). "Adherence to these principles is particularly appropriate in a case like this involving interpretation of documents drafted by sophisticated, counseled parties and involving the loan of substantial sums of money." *Id.*

II. JURISDICTION AND GOVERNING LAW

[1] We have jurisdiction to hear appeals from the Bankruptcy and District Courts in this Circuit under 28 U.S.C. §§ 158 and 1291. Statutory construction and contract interpretation are legal questions reviewed anew by us. The contracts at issue—the Indentures that control the Notes—are governed by New York law. First Lien Indenture § 13.08; Second Lien Indenture § 13.08.

[2] **[3]** "When interpreting state law, we follow a state's highest court; if that state's highest court has not provided guidance, we are charged with predicting how that court would resolve the issue." *Illinois Nat. Ins. Co. v. Wyndham Worldwide Operations, Inc.*, 653 F.3d 225, 231 (3d Cir. 2011). "To do so, we must take into consideration: (1) what that court has said in related areas; (2) the decisional law of the state intermediate courts; (3) federal cases interpreting state law; and (4) decisions from other jurisdictions that have discussed the issue." *Id.*

***4** **[4]** **[5]** **[6]** **[7]** Here we look to the New York Court of Appeals, which has held that "[t]he fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties' intent." *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 750 N.Y.S.2d 565, 780 N.E.2d 166, 170 (2002) (internal citations and quotation marks omitted). "The best evidence of what parties to a written agreement intend is what they say in their writing." *Id.* "It is the role of the courts to enforce the agreement made by the parties —not to add, excise or distort the meaning of the terms they chose to include, thereby creating a new contract under the guise of construction." *NML Capital v. Republic of Argentina*, 17 N.Y.3d 250, 928 N.Y.S.2d 666, 952 N.E.2d 482, 489–90

III. ANALYSIS

A. The First Lien Indenture Although both Indentures contains many provisions, this case centers on the words of but two: §§ 3.07 and

6.02.[2] The former, noted earlier as titled "Optional Redemption," states when the make-whole is due: "At any time prior to December 1, 2015, the Issuer may redeem all or a part of the Notes at a redemption price equal to 100% of the principal amount of the Notes redeemed plus the Applicable Premium [*i.e.*, the make-whole] ... and accrued and unpaid interest" (emphasis in original). Indenture § 3.07. The premium decreases annually on a sliding scale between December 1, 2015 and November 30, 2018. From December 1, 2018 until the Notes' maturity date in 2020, the Notes may be optionally redeemed without payment of a premium. *See* Indenture §§ 1.01 (defining "Applicable Premium" and providing formula for its application) & 3.07(d) (setting premium amount for redemptions after December 1, 2015).

Section 6.02 provides that on the filing of a bankruptcy petition by EFIH "all outstanding Notes shall be due and payable immediately without further action or notice." Indenture § 6.02; *see also id.* § 6.01 (defining bankruptcy as an event of default).

Any duty to pay the make-whole comes from § 3.07. It leaves us with three questions: was there a redemption; was it optional; and if yes to both, did it occur before December 1, 2015?

Section 3.07 does not define "redemption." As a redemption "usu[ally] refers to the repurchase of a bond before maturity," Black's Law Dictionary 1390 (9th ed. 2009), EFIH contends that we should limit the term to mean only repayments of debt that pre-date the debt's maturity. Section 6.02 accelerated the Notes' maturity to the date EFIH entered bankruptcy—April 29, 2014. It refinanced the Notes several weeks later. Thus it argues that its post-maturity refinancing was not a redemption.

[8] But contrary to that position, New York and federal courts deem "redemption" to include both pre- and post-maturity repayments of debt. *See e.g.*, *Chesapeake Energy Corp. v. Bank of N.Y. Mellon*, 773 F.3d 110, 116 (2d Cir. 2014) (in interpreting New York law, to "redeem" is to "repay[ ] ... a debt security ... at or before maturity" (quoting *Barron's Dictionary of Finance and Investment Terms* 587 (8th ed.

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2010))); *Treasurer of New Jersey v. U.S. Dep't of Treasury*, 684 F.3d 382, 388 (3d Cir. 2012) (discussing regulations permitting bondholders to "present ... long-matured savings bond[s] for redemption"); *Fed. Nat'l Mortg. Ass'n v. Miller*, 123 Misc.2d 431, 473 N.Y.S.2d 743, 744 (N.Y. Sup. Ct. 1984) ("debtor may redeem" mortgage by "pay [ing] ... accelerated debt"); *see also* N.Y. U.C.C. § 9–623, Official Comment No. 2 ("To redeem the collateral ... of a secured obligation [that] has been accelerated, it would be necessary to tender the entire balance."). Accordingly, EFIH's June 19, 2014 refinancing was a "redemption" within the meaning of § 3.07.

***5** **[9]** Whether the redemption was "[o]ptional" is next up. EFIH argues that refinancing the Notes was not optional because § 6.02 made them "due and payable immediately without further action or notice" once it was in bankruptcy. EFIH, however, filed for Chapter 11 protection voluntarily. Once there, it had the option, per its plan of reorganization, to reinstate the accelerated Notes' original maturity date under Bankruptcy Code § 1124(2) rather than paying them off immediately. It chose not to do so, and instead followed the path laid out six months before in its SEC 8–K filing.

EFIH contends nonetheless that any redemption was mandatory rather than optional. But this contention does not match the facts. Indeed "a chapter 11 debtor that has the capacity to refinance secured debt on better terms ... is in the same position within bankruptcy as it would be outside bankruptcy, and cannot reasonably assert that its repayment of debt is not 'voluntary.' " Scott K. Charles & Emil A. Kleinhaus, *Prepayment Clauses in Bankruptcy*, 15 Am. Bankr. Inst. L. Rev. 537, 552 (2007).

Events leading up to the post-petition financing on June 19, 2014 demonstrate that the redemption was very much at EFIH's option. To repeat, months before its Chapter 11 filing EFIH announced its plan to redeem the Notes before their stated maturity date. *In re Energy Future Holdings Corp.*, 527 B.R. at 189. And after filing for bankruptcy, it produced another 8–K stating that it may, "but [wa]s under no obligation" to, redeem the similarly situated Second Lien Notes. *In Re Energy Future Holdings Corp.*, No. 14–50363 (Bankr. D. Del.), Docket Entry 181, A–222.

The irony is that the Noteholders did not want to be paid back on June 19, 2014. They attempted to rescind the Notes' acceleration on June 4, 2014, but were blocked by the automatic stay. *In re Energy Future Holdings Corp.*, 533 B.R. at 108. When EFIH redeemed the Notes, it did so "on a non-consensual basis," that is, over the Noteholders' objection. J.A. 1214. Logic leaves no doubt this redemption of the Notes was "[o]ptional" under §
3.07.

[10] And, only to close the loop, all this occurred before December 1, 2015. Hence § 3.07 on its face requires that EFIH pay the Noteholders the yield-protection payment.

B. The Relationship Between §§ 3.07 And 6.02 (Or Whether § 6.02, Once Triggered, Annuls § 3.07)

[11] At oral argument, EFIH's counsel described §§ 3.07 and 6.02 as "different pathways" that we must choose between. Only the latter is relevant, the argument goes, because it addresses post-maturity payment more specifically than § 3.07, and specific contract provisions govern over more general ones. *See Muzak Corp. v. Hotel Taft Corp.*, 1 N.Y.2d 42, 150 N.Y.S.2d 171, 133 N.E.2d 688, 690 (1956).

It is not obvious why EFIH believes § 6.02 addresses the consequences of the June 2014 redemption more specifically than § 3.07 or why we must choose between them. The two sections simply address different things: § 6.02 causes the maturity of EFIH's debt to accelerate on its bankruptcy, and § 3.07 causes a make-whole to become due when there is an optional redemption before December 1, 2015. Rather than "different pathways," together they form the map to guide the parties through a post-acceleration redemption. In any event, § 3.07 is the only provision that specifically addresses redemptions.

To support its position, EFIH looks primarily to *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013). It focused on an indenture's acceleration provision to determine whether a make-whole was due. Crucially, however, that provision addressed outright whether a make-whole would be due following acceleration.

> ***6** "[I]f an Event of Default referred to in ... Section 4.01(g) [*i.e.*, the voluntary filing of a bankruptcy petition] ... shall have occurred and be continuing, then and in every such case the unpaid principal amount of the Equipment Notes then outstanding, together with accrued but unpaid interest thereon and all other amounts due thereunder **(but**

> **for the avoidance of doubt, without Make–Whole Amount)**, shall immediately and without further act become due and payable without presentment, demand, protest or notice, all of which are hereby waived."

Id. at 99 (emphasis added).

AMR is the easy case; just follow the text. The litigants took a route suggested by the New York Court of Appeals in *NML Capital v. Republic of Argentina*: parties that want obligations to cease when accelerated should say so in their agreement. 928 N.Y.S.2d 666, 952 N.E.2d at 490 ("Had Argentina intended that its responsibility to pay interest twice a year cease upon maturity, it could easily have clarified that intent in any number of ways.").

[12] In our case, § 6.02 makes no mention of the makewhole. EFIH argues that this silence saps § 3.07's effect. On a general note, that reading would cross cords with our duty to "give full meaning and effect to all of [the Indenture's] provisions." *Chesapeake Energy Corp.*, 773 F.3d at 113–14 (internal quotation marks omitted). "Contracts are ... to be interpreted to avoid inconsistencies and to give meaning to all [their] terms." *Barrow v. Lawrence United Corp.,* 146 A.D.2d 15, 18, 538 N.Y.S.2d 363 (N.Y. App. Div. 1989). More specifically, EFIH's interpretation conflicts with the New York Court of Appeals' statement that "[w]hile it is understood that acceleration advances the maturity date of the debt," there is no "rule of New York law declaring that other terms of the contract not necessarily impacted by acceleration ... automatically cease to be enforceable after acceleration." *NML Capital*, 928 N.Y.S.2d 666, 952 N.E.2d at 492. Accordingly, § 3.07 stands on its own, unswayed by the Indenture's other provisions.

EFIH alternatively argues that §§ 6.02 and 3.07 are in conflict, so that only one may apply to the June 2014 redemption. Subsection 3.07(e) prescribes detailed notice procedures for EFIH to follow before redeeming the Notes, while § 6.02 makes the Notes "due and payable immediately without further action or notice." If the notice procedures were not followed, no redemption could follow. Yet EFIH offers no reason why it could not have complied with § 3.07(e)'s notice procedures. In any event, it cannot use its own failure to notify to absolve its duty to pay the make-whole. Any conflict between the two provisions in this instance is illusory.

We know no reason why we should choose between §§ 3.07 and 6.02 when both plainly apply. By its own terms, § 3.07 governs the optional redemption embedded in the refinancing and requires payment of the make-whole. It surpasses strange to hold that silence in § 6.02 supersedes § 3.07's simple script.

C. The Second Lien Indenture's Additional Language

[13] As mentioned above, the Second Lien Indenture's acceleration provision contains words not present in the First Lien Indenture. These additions make explicit in the Second Lien Indenture the link between acceleration under § 6.02 and the make-whole for an optional redemption per § 3.07. While for the First Lien Indenture these concepts are without cross-reference and separate, in the Second Lien Indenture they are tied together. Sections 3.07 and 6.02 are not merely compatible but complementary. In any event, the result is the same no matter the Indenture—there were optional redemptions before a date certain, thereby triggering make-whole premiums.

***7** When EFIH filed its bankruptcy petition, Second Lien Indenture § 6.02 caused "all principal of and *premium, if any*, interest ... [,] and any other monetary obligations on the outstanding [Second Lien] Notes [to] be[come] due and payable immediately" (emphasis added). Compare First Lien Indenture § 6.02 ("all outstanding Notes shall be due and payable immediately"). The words "premium, if any," are most naturally read to reference § 3.07's "Applicable Premium"—that is, the make-whole.

The most EFIH musters is that the Second Lien Indenture could have been even more specific by replacing "premium, if any," with "a premium owed under section 3.07" or "Applicable Premium or other premium owed as if repayment under this section were an Optional Redemption under section 3.07." EFIH's Br. at 24–25. But we see no reason to demand such exactness. Indeed, EFIH has not suggested any other "premium" the drafters could have had in mind.

True, in a case called *Momentive*, the Bankruptcy Court for the Southern District of New York held the words "premium, if any," were not specific enough to require payment of a

make-whole in similar circumstances. *In re MPM Silicones, LLC*, No. 14–22503–RDD, 2014 WL 4436335, at *13 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R. 321 (S.D.N.Y. 2015) ("*Momentive*"). We believe, however, the result in *Momentive* conflicts with that indenture's text and fails to honor the parties' bargain. For these and additional reasons discussed below, we find it unpersuasive.

By including the words "premium, if any," in its acceleration provision, the Second Lien Indenture leaves no doubt that §§ 3.07 and 6.02 work together. The latter is explicit that a premium is in play, and the only relevant premium provision is the former. Thus both remained applicable following bankruptcy, and, pursuant to the agreement struck with the Second Lien Noteholders, they are entitled to the make-whole.

D. The Effect of Acceleration on Make–Whole Provisions

[14] Notwithstanding the result dictated by § 3.07's text in both Indentures, EFIH asserts that it should not have to pay the make-whole because § 6.02 caused the Notes' maturity to accelerate before it paid them off. Citing a New York trial court opinion, *Nw. Mut. Life Ins. Co. v. Uniondale Realty Assocs.*, 11 Misc.3d 980, 816 N.Y.S.2d 831, 836 (N.Y. Sup. Ct. 2006) ("*Northwestern*"), it argues that courts must close their eyes to make-whole provisions once a debt's maturity has accelerated.

[15] In interpreting laws of a state, we need not follow the judgments of its trial courts. *See MRL Dev. I, LLC v. Whitecap Inv. Corp.*, 823 F.3d 195, 203 (3d Cir. 2016) ("The Superior Court of the Virgin Islands ... is not the highest court of the Territory or even an intermediate appellate court, but rather a trial court. Accordingly, we are not bound by Superior Court decisions" (internal brackets, citations, and quotation marks omitted)). But even if we were inclined to do so here, EFIH's interpretation of *Northwestern* conflicts with the pronouncements of New York's highest court, which we follow on questions of New York law. *See Illinois Nat. Ins. Co.*, 653 F.3d at 231.

[16] As we noted above, the New York Court of Appeals stated unequivocally in *NML Capital v. Republic of Argentina* that "[w]hile it is understood that acceleration advances the maturity date of the debt, [it was] unaware of any rule of New York law declaring that other terms of the contract not necessarily impacted by acceleration ... automatically cease to be enforceable after acceleration." 928 N.Y.S.2d 666, 952 N.E.2d at 492. Put differently, contract terms like § 3.07 that are applicable before acceleration remain so afterward.

***8** In *NML Capital*, New York's highest Court answered several questions certified to it by the U.S. Court of Appeals for the Second Circuit. *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 486. Among them was "whether Argentina's obligation to make [certain contractually established interest] payments to bondholders continued after maturity or acceleration of the indebtedness [.]" *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 486, . Argentina contended that, after the maturity of its debt had accelerated, bondholders were entitled only to their principal and any accrued interest. *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 490. Acceleration, it argued, terminated its duty to make biannual interest payments mandated by the bond documents. *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 487.

In rejecting those assertions, the New York Court of Appeals held that "in New York the consequences of acceleration of the debt depend on the language chosen by the parties in the pertinent loan agreement." *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 492. "Had Argentina ... intended that its responsibility to pay interest twice a year cease upon maturity, it could easily have clarified that intent in any number of ways." *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 490. For example, the bond documents could have specified that the payment "obligation continued 'until' the maturity date" or could have provided "that interest payments were to be made until the principal was due, thereby referring back to the loan maturity date." *Id.* However, because the bond language that Argentina pay biannual interest payments made no reference to acceleration or maturity, it remained effective following the bonds' acceleration. *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 493. The takeaway for us is that § 3.07 applies no less following acceleration of the Notes' maturity than it would to a pre-acceleration redemption.

Despite the New York Court of Appeals' holding in *NML Capital* and still riding the *Northwestern* horse, EFIH contends that we should decline to require payment of the make-whole because the trial court declared that a "prepayment premium will not be enforced under default circumstances in the absence of a clause which so states[.]" *Northwestern*, 816 N.Y.S.2d at 836. It held that a mortgage lender who chose to foreclose following default was not entitled to a "prepayment premium" because foreclosure had advanced the debt's maturity date. *Id.* "[P]repayment is

a payment *before* maturity[,]" but after foreclosure prepayment is impossible as the debt has become due and payable immediately. *Id.* at 837 (emphasis in original). According to EFIH, *Northwestern* sets a rule that, unless an agreement clearly provides for it, no makewhole payment is due after a note's acceleration.

[17] No doubt prepayment premiums are the price of "an option voluntarily to prepay the loan and terminate the mortgage before the maturity." *In re S. Side House, LLC,* 451 B.R. 248, 267 (Bankr. E.D.N.Y. 2011), *aff'd sub nom.*, *U.S. Bank Nat. Ass'n v. S. Side House, LLC*, No. 11–CV–4135 ARR, 2012 WL 273119 (E.D.N.Y. Jan. 30, 2012); *accord Northwestern*, 816 N.Y.S.2d at 836. "[A]cceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead is payment made after maturity [,]" and logically the option to prepay can no longer be exercised after maturity. *Matter of LHD Realty Corp.*, 726 F.2d 327, 330–31 (7th Cir. 1984); *D.I.S., LLC v. Sagos*, 38 A.D.3d 543, 832 N.Y.S.2d 581, 582 (2007) ("prepayment" penalty did not apply to tender of mortgage principal and interest following acceleration because post-acceleration payments are not "prepayments").

[18] **[19]** Unlike prepayment, however, "redemption" of "a debt security" may occur "*at* or before maturity." *Chesapeake Energy Corp.*, 773 F.3d at 116 (emphasis added). Thus, while a premium contingent on "prepayment" could not take effect after the debt's maturity,[3] a premium tied to a "redemption" would be unaffected by acceleration of a debt's maturity.

***9** Our understanding of New York law is that it follows a logical path: prepayments cannot occur when payment is now due by acceleration of the debt's maturity. If parties want to mandate a "prepayment" premium following acceleration, they must clearly state it in their agreement. This is the *Northwestern* rule.

Recently, however, bankruptcy courts, including the Bankruptcy Court here, have stretched *Northwestern* beyond its language and applied its clear-statement rule to yield-protection payments not styled as prepayment premiums. In the *Momentive* case we mentioned in our discussion of the Second Lien Indenture, a Bankruptcy Court considered language similar to that of both Indentures and nearly identical to the text of the Second Lien Indenture. Like the Indentures here, the *Momentive* indenture required payment of a make-whole on optional redemptions occurring before a particular date. *Momentive*, 2014 WL 4436335, at *13. The Court, however, disallowed the lenders' claim for a make-whole, declaring it "well-settled law in New York" that a make-whole, like a prepayment premium, will only be due on a default and acceleration "when a clear and unambiguous clause calls" for it. *Momentive*, 2014 WL 4436335, at *12–*13 (citing *Northwestern*). The Delaware Bankruptcy Court followed the same line, declining to enforce the make-whole provision because "an indenture must contain express language requiring payment of a prepayment premium upon acceleration; otherwise, it is not owed." *In re Energy Future Holdings Corp.*, 527 B.R. at 192 (construing First Lien Indenture); *accord In re Energy Future Holdings Corp.*, 539 B.R. at 733 (construing Second Lien Indenture).

By denying the make-whole after the Notes' acceleration, the Bankruptcy Court pushed the *Northwestern* rule beyond its language and underlying policy concerns. First, its application of the rule is off point because § 3.07 in the Indentures does not use the word "prepayment." *Northwestern* responds, in part, to the linguistic paradox created by the idea of a *pre*payment following acceleration. "Once the maturity date is accelerated to the present, it is no longer possible to prepay the debt before maturity." *Northwestern*, 816 N.Y.S.2d at 834. That is why, if parties want a "prepayment" premium to survive acceleration and maturity, they must clearly state it.

The Indentures here present no linguistic tension to resolve. Nothing in § 6.02 negates the premium § 3.07 requires if an optional redemption occurs before a stated date. Acceleration here has no bearing on whether and when the make-whole is due.

[20] EFIH argues that, even though § 3.07 does not use the word "prepayment," the make-whole is in substance a prepayment premium, and thus the *Northwestern* rule should apply. But we must give effect to the "words and phrases" the parties chose. *Chesapeake Energy Corp.*, 773 F.3d at 113–14; *NML Capital*, 928 N.Y.S.2d 666, 952 N.E.2d at 489–90. By avoiding the word "prepayment" and using the term "redemption," they decided that the make-whole would apply without regard to the Notes' maturity.

Moreover, beneath the *Northwestern* holding was a policy concern that lenders should not be permitted "to recover prepayment premiums after default and acceleration in order to preserve an income stream ... absent any 'voluntary' prepayment." *Northwestern*, 816 N.Y.S.2d at 836. There the

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mortgagee seeking the prepayment premium had elected to foreclose in order to recoup its investment immediately. *Id.* at 833. Ordinarily, by electing to accelerate the debt, a lender forgoes its right to a stream of payments in favor of immediate repayment. *Matter of LHD Realty Corp.*, 726 F.2d at 331 & n.4. The *Northwestern* Judge was concerned that lenders should not be able to seek immediate repayment and pile on by also receiving a premium. Here, by contrast, the Noteholders did not seek immediate payment. EFIH voluntarily redeemed the Notes over the Noteholders' objection. Hence even the policy guiding *Northwestern* does not reach this case.

***10** Finally, to repeat what we said at the outset, by declining to enforce § 3.07 after acceleration, the Bankruptcy Court ran afoul of New York authority by failing to enforce a contract provision—§ 3.07—not affected by acceleration. *NML Capital*, 928 N.Y.S.2d 666, 952 N.E.2d at 492. To reach its conclusion, it followed *Momentive*, which described "automatic acceleration clauses" as "negating" the effect of makewhole redemption provisions. *Momentive*, 2014 WL 4436335, at *14. That is not what *NML Capital* tells us.

EFIH answers that the Noteholders should have taken note of bankruptcy courts' novel application of *Northwestern* and insisted on clearer language in the Indenture. *See e.g., In re Anchor Resolution Corp.*, 221 B.R. 330, 334 (Bankr. D. Del. 1998) ("If the maturity of any Series B Note shall be accelerated ... [,] there shall become due and payable ... as compensation to the holders ... a premium equal to the Make–Whole Amount."). But this puts the burden backward; if EFIH wanted its duty to pay the make-whole on optional redemption to terminate on acceleration of its debt, it needed to make clear that § 6.02 trumps § 3.07. *See NML Capital*, 928 N.Y.S.2d 666, 952 N.E.2d at 490. The burden to make that showing is with EFIH. To place it on the Noteholders for EFIH's decision to redeem the Notes is a bridge too far.

* * * * *

Our "primary objective ... is to give effect to the intent of the parties as revealed by the language of their agreement." *Chesapeake Energy Corp.*, 773 F.3d at 113– 14. The language of the First Lien Indenture requires EFIH to pay a make-whole if it redeems the First Lien Notes at its option before December 1, 2015, and the Second Lien Indenture requires the same for redemptions of Second Lien Notes before May 15, 2016 or March 1, 2017 (depending on the initial maturity date of the particular debt instruments). EFIH redeemed the First Lien Notes at its option on June 19, 2014 and redeemed a portion of the Second Lien Notes on March 10, 2015. Redemptions, not prepayments, occurred here, they were at the election of EFIH, and they occurred before the respective dates noted. Statements of New York law by its highest Court and the federal Circuit Court in New York reinforce our conclusion that EFIH must pay the makewhole per the Indenture language before us.[4]

The judgments of the District Court are reversed with instructions to remand to the Bankruptcy Court for further proceedings consistent with this opinion. Any future appeals shall return to this panel.

All Citations

--- F.3d ----, 2016 WL 6803710, 63 Bankr.Ct.Dec. 95

Footnotes

* Honorable D. Brooks Smith, United States Circuit Judge for the Third Circuit, assumed Chief Judge status on October 1, 2016.

1 For the purpose of determining EFIH's duty to pay any make-whole, the Bankruptcy Court assumed that it was "solvent and able to pay all allowed claims of [its] creditors in full." *In re Energy Future Holdings Corp.*, 527 B.R. at 183. We do the same. Because we do not have any briefing on the matter even without that assumption, we do not consider whether insolvency might have affected EFIH's obligations.

2 In Sections A and B, we refer for convenience to the First Lien Indenture simply as the "Indenture." Likewise, we mean the First Lien Notes and First Lien Noteholders when we refer to "the Notes" or "the Noteholders" in these Sections. Thereafter the two terms mean all debt instruments and their holders under both the First Lien and Second Lien Indentures, which themselves may be referred to collectively as the "Indentures."

3 Even though a debtor cannot prepay what is already due, courts have enforced prepayment premiums after acceleration when the debtor has intentionally defaulted in order to avoid the premium. *See e.g., In re S. Side House, LLC*, 451 B.R. at 269; *Northwestern*, 816 N.Y.S.2d at 836.

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4 Because we hold that the Noteholders are entitled to the make-whole, we do not reach the Trustees' alternative arguments that the Bankruptcy Court should have lifted the automatic stay to permit rescission of the Notes' acceleration or that the Court should have allowed the Noteholders a contingent claim for the make-whole or a claim for contract damages.

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KeyCite Blue Flag – Appeal Notification
Petition for Certiorari Docketed by CHAILLE DUBOIS, FKA CHAILLE GAINES, FKA CANDACE DUBOIS, FKA CANDACE GAINES, FKA CANDI GAINES, FKA CANDI DUBOIS, ET AL. v. ATLAS ACQUISITIONS, LLC, U.S., November 28, 2016

834 F.3d 522
United States Court of Appeals, Fourth Circuit.

In re: Eric Dubois, Debtor. Chaille Dubois, f/k/a Chaille Gaines, f/k/ a Candace DuBois, f/k/a Candace Gaines, f/k/a Candi Gaines, f/k/a Candi DuBois; Kimberly Adkins, Plaintiffs–Appellants,
v.
Atlas Acquisitions LLC, Defendant–Appellee, and Timothy P. Branigan; Nancy Spencer Grisby, Trustees.

No. 15–1945
|
Argued: May 10, 2016
|
Decided: August 25, 2016

Synopsis
Background: Debtors brought adversary proceedings in separate Chapter 13 cases, asserting that debt collectors had violated the Fair Debt Collection Practices Act (FDCPA) by filing stale proofs of claim against their bankruptcy estates. The United States Bankruptcy Court for the District of Maryland, Thomas J. Catliota, J., granted motions to dismiss FDCPA claims as failing to state cause of action, and debtors appealed directly to the Court of Appeals.

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

[1] filing of proof of claim in debtor's bankruptcy case is“debt collection activity” regulated by the FDCPA;

[2] time-barred debt falls within the Bankruptcy Code'sbroad definition of a “claim”; but

[3] filing of proof of claim in Chapter 13 case based ondebt that is time-barred does not violate the FDCPA, at least not where expiration of statute of limitations does not extinguish the debt under the applicable state law.

Affirmed.

Diaz, Circuit Judge, filed dissenting opinion, joining in part in the majority opinion.

West Headnotes (18)

[1] Bankruptcy
Proof; F iling
“Proof of claim” is form filed by creditor in bankruptcy proceeding that states the amount that debtor owes to creditor and reason for the debt.

2 Cases that cite this headnote

[2] Bankruptcy
Conclusions of law; d e novo review
On appeal directly from bankruptcy court, the Court of Appeals would review bankruptcy court's grant of motion to dismiss for failure to state claim de novo. Fed. R. Civ. P. 12(b)(6).

Cases that cite this headnote

[3] Bankruptcy
Protection Against Discrimination or Collection Efforts in General; ‘ Fresh Start.‘
Principal purpose of the Bankruptcy Code is to grant fresh start to the honest but unfortunate debtor. 11 U.S.C.A. § 101 et seq.

1 Cases that cite this headnote

[4] Bankruptcy
Requisites in general
Being all-inclusive on bankruptcy schedules is consistent with the Bankruptcy Code's principle of honest and full disclosure. 11 U.S.C.A. § 101 et seq.

Cases that cite this headnote

[5] Antitrust and Trade Regulation

Practices prohibited or required in general

Debt collector violates the Fair Debt Collection Practices Act (FDCPA) by filing lawsuit or threatening to file lawsuit to collect a time-barred debt. Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

1 Cases that cite this headnote

[6] **Antitrust and Trade Regulation**

Practices prohibited or required in general

Bankruptcy

Proof; F iling

Filing of proof of claim in debtor's bankruptcy case is “debt collection activity” regulated by the Fair Debt Collection Practices Act (FDCPA), though proof of claim is filed with bankruptcy court for purposes of obtaining payment on debt, not from debtor, but from debtor's bankruptcy estate. Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

1 Cases that cite this headnote

[7] **Antitrust and Trade Regulation**

Communications, representations, and notices; d ebtor's response

Determining whether a communication constitutes an attempt to collect debt, of kind subject to the Fair Debt Collection Practices Act (FDCPA), is commonsense inquiry, that requires court to evaluate the nature of parties' relationship, the objective purpose and context of the communication, and whether the communication includes demand for payment. Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

Cases that cite this headnote

[8] **Antitrust and Trade Regulation**

Practices prohibited or required in general

Bankruptcy

Proceedings, Acts, or Persons Affected

Interpreting “debt collection activity,” of kind regulated by the Fair Debt Collection Practices Act (FDCPA), to include the filing of proof of claim in debtor's bankruptcy case was not inconsistent with prohibition against postpetition debt collection activity by automatic stay, which applied only to debt collection activity outside of bankruptcy case. 11 U.S.C.A. § 362(a); Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

Cases that cite this headnote

[9] **Bankruptcy**

Proceedings, Acts, or Persons Affected

Automatic stay simply bars actions to collect debt outside of, not within, bankruptcy proceeding. 11 U.S.C.A. § 362(a).

Cases that cite this headnote

[10] **Bankruptcy**

Automatic Stay

Automatic stay helps channel debt collection activity into the bankruptcy process. 11 U.S.C.A. § 362(a).

Cases that cite this headnote

[11] **Antitrust and Trade Regulation**

Persons and transactions covered

Debt collection activity directed toward someone other than debtor may still be actionable under the Fair Debt Collection Practices Act (FDCPA). Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

Cases that cite this headnote

[12] **Bankruptcy**

Claims allowable; w hat constitutes ‘claim.‘

Time-barred debt falls within the Bankruptcy Code's broad definition of a “claim.” 11 U.S.C.A. § 101(5)(A).

1 Cases that cite this headnote

[13] Bankruptcy

Claims allowable; w hat constitutes ‘claim.‘

Term “claim,” as used in the Bankruptcy Code, usually refers to a right to payment recognized under state law. 11 U.S.C.A. § 101(5)(A).

Cases that cite this headnote

[14] Limitation of Actions

Operation as to rights or remedies in general

Under Maryland law, statute of limitations does not operate to extinguish a debt, but merely to bar the remedy.

Cases that cite this headnote

[15] Limitation of Actions

Renewal or revival of cause of action

Under Maryland law, stale debt may be revived if debtor sufficiently acknowledges the debt's existence.

Cases that cite this headnote

[16] Bankruptcy

Claims allowable; w hat constitutes ‘claim.‘

Under Maryland law, time-barred debt still constitutes a right to payment and therefore a “claim” that the holder may file under the Bankruptcy Code. 11 U.S.C.A. § 101(5)(A).

Cases that cite this headnote

[17] Bankruptcy

Claims allowable; w hat constitutes ‘claim.‘

Debt need not be enforceable in court in order to be a “claim,” as that term is used in the Bankruptcy Code. 11 U.S.C.A. § 101(5)(A).

Cases that cite this headnote

[18] Antitrust and Trade Regulation

Practices prohibited or required in general

Bankruptcy

Time for Filing

Filing of proof of claim in Chapter 13 case based on debt that is time-barred does not violate the Fair Debt Collection Practices Act (FDCPA), where expiration of statute of limitations does not extinguish the debt under applicable state law. Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

1 Cases that cite this headnote

***524** Appeal from the United States Bankruptcy Court for the District of Maryland, at Greenbelt. Thomas J. Catliota, Bankruptcy Judge. (15–00110; 14–28589)

Attorneys and Law Firms

ARGUED: Morgan William Fisher, LAW OFFICES OF MORGAN FISHER LLC, Annapolis, Maryland, for Appellants. Donald S. Maurice, Jr., MAURICE WUTSCHER, LLP, Flemington, New Jersey, for Appellee. ON BRIEF: Courtney L. Weiner, LAW OFFICES OF MORGAN FISHER LLC, Washington, D.C., for Appellants. Alan C. Hochheiser, BUCKLEY KING, LPA, Cleveland, Ohio, for Appellee.

Before DIAZ, FLOYD, and THACKER, Circuit Judges.

Opinion

***525** Affirmed by published opinion. Judge Floyd wrote the majority opinion, in which Judge Thacker joined. Judge Diaz wrote a dissenting opinion.

FLOYD, Circuit Judge:

[1] Appellants Kimberly Adkins and Chaille Dubois filed separate Chapter 13 bankruptcy petitions in the Bankruptcy Court for the District of Maryland. Appellee Atlas Acquisitions LLC (Atlas) filed proofs of claim in their bankruptcy cases based on debts that were barred by

Maryland's statute of limitations.[1] The issue on appeal is whether Atlas violated the Fair Debt Collection Practices Act (FDCPA) by filing proofs of claim based on timebarred debts. We hold that Atlas's conduct does not violate the

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FDCPA, and affirm the bankruptcy court's dismissal of Appellants' FDCPA claims and related state law claim.

I.

The facts of Appellants' cases are similar. Adkins filed for Chapter 13 bankruptcy on August 29, 2014. Atlas filed two proofs of claim in her case. The first proof of claim indicated that Adkins owed Atlas $184.62 based on a loan that originated with payday lender Check N Go and that Atlas purchased from Elite Enterprise Services, LLC

(Elite Enterprise) on September 15, 2014.[2] The proof of claim identified the last transaction date on the account as May 19, 2009. Atlas's second proof of claim was for $390.00 based on a loan that originated with payday lender Impact Cash USA and that Atlas purchased from Elite Enterprise on November 18, 2014. The proof of claim identified the last transaction date on that account as September 10, 2009. It is undisputed that both debts were beyond Maryland's three-year statute of limitations when Atlas purchased and attempted to assert the debts in Adkins's bankruptcy case. See Md. Code Ann., Cts. & Jud. Proc. § 5–101. Adkins neither listed the debts on her bankruptcy schedules nor sent a notice of bankruptcy to Atlas.

Dubois filed for Chapter 13 bankruptcy on December 6, 2014. Atlas filed a proof of claim for $135.00 based on a loan that originated with payday lender Iadvance and that Atlas purchased from Elite Enterprise on January 5, 2015. The proof of claim identified the last transaction date on the account as October 18, 2008. It is undisputed that this debt was also beyond Maryland's statute of limitations when Atlas purchased and attempted to assert the debt in Dubois's bankruptcy case. Dubois did not list the debt on her bankruptcy schedules nor did she send a notice of bankruptcy to Atlas.

Adkins and Dubois filed separate adversary complaints against Atlas. Both objected to Atlas's claims as being time-barred and further alleged that Atlas violated the FDCPA by filing proofs of claim on stale debts. Appellants sought disallowance of Atlas's claims as well as damages, attorney's fees, and costs under the FDCPA.[3]

[2] ***526** Atlas conceded that its claims were based on time-barred debts and stipulated to their disallowance. However, Atlas moved to dismiss Appellants' FDCPA claims under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief could be granted. See Fed. R. Bankr. P. 7012(b) (incorporating Rule 12(b)(6) into adversary proceedings). After hearing consolidated oral arguments, the bankruptcy court concluded that filing a proof of claim does not constitute debt collection activity within the meaning of the FDCPA and granted Atlas's motion to dismiss. Pursuant 28 U.S.C. § 158(d)(2), we permitted Appellants to appeal the bankruptcy court's decision directly to this Court. We review the bankruptcy court's dismissal of Appellants' claims under Rule 12(b)(6) de novo. See, e.g., In re Mwangi, 764 F.3d 1168, 1173 (9th Cir. 2014); In re McKenzie, 716 F.3d 404, 412 (6th Cir. 2013).

II.

Before addressing the substance of Appellants' claims, we provide a brief overview of the relevant statutes in this case: the Bankruptcy Code (the "Code") and the FDCPA.

A.

[3] **[4]** "The principal purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortunate debtor.' " Marrama v. Citizens Bank, 549 U.S. 365, 367, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007) (quoting Grogan v. Garner, 498 U.S. 279, 286, 287, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991)). Through bankruptcy, the debtor's assets are collected for equitable distribution among creditors and his remaining debts are discharged. See Covert v. LVNV Funding, LLC, 779 F.3d 242, 248 (4th Cir. 2015); In re Jahrling, 816 F.3d 921, 924 (7th Cir. 2016). A bankruptcy debtor must file with the bankruptcy court a list of creditors, a schedule of assets and liabilities, and a statement of the debtor's financial affairs. 11 U.S.C. § 521(a)(1). "[B]eing all-inclusive on the schedules is consistent with the Code's principle of honest and full disclosure." In re Vaughn, 536 B.R. 670, 676 (Bankr. D.S.C. 2015). Scheduling a debt notifies the creditor of the bankruptcy and of the creditor's opportunity to file a proof of claim asserting a right to payment against the debtor's estate. See id. at 679; 11 U.S.C. § 501(a).

The bankruptcy court may "allow" or "disallow" claims from sharing in the distribution of the bankruptcy estate. 11 U.S.C. § 502. In Chapter 13 proceedings, allowed claims are typically

paid, either in whole or in part, out of the debtor's future earnings pursuant to a repayment plan proposed by the debtor and confirmed by the bankruptcy court. See id. § 1322(a)(1); 4–501 Collier on Bankruptcy ¶ 501.01 (Collier). Upon completion of all payments under the plan, the bankruptcy court "grant[s] the debtor a discharge of all debts provided for by the plan or disallowed." 11 U.S.C. § 1328(a). Thus, at the end of the process the debtor receives the "fresh start" contemplated by the Bankruptcy Code.

B.

Congress enacted the FDCPA to eliminate abusive debt collection practices and to ensure that debt collectors who refrain from such practices are not competitively disadvantaged. 15 U.S.C. § 1692(a), (e). The FDCPA regulates the conduct of "debt collectors," defined to include "any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted ***527** to be owed or due another." Id. § 1692a(6). Among other things, the FDCPA prohibits debt collectors from using "any false, deceptive, or misleading representation or means in connection with the collection of any debt," and from using "unfair or unconscionable means to collect or attempt to collect any debt." Id. §§ 1692e–1692f. The statute provides a non-exhaustive list of conduct that is deceptive or unfair (e.g., falsely implying that the debt collector is affiliated with the United States, id. § 1692e(1)). Debt collectors who violate the FDCPA are liable for actual damages, statutory damages of up to $1,000, and attorney's fees and costs. See id. § 1692k(a).

C.

[5] Federal courts have consistently held that a debt collector violates the FDCPA by filing a lawsuit or threatening to file a lawsuit to collect a time-barred debt. See Crawford v. LVNV Funding, LLC, 758 F.3d 1254, 1259–60 (11th Cir. 2014) (collecting cases), cert. denied, ––– U.S. ––––, 135 S.Ct. 1844, 191 L.Ed.2d 724 (2015). Appellants contend that filing a proof of claim on a timebarred debt in a bankruptcy proceeding similarly violates the FDCPA. Atlas counters that filing a proof of claim is not debt collection activity and is therefore not subject to the FDCPA. Alas further argues that, even if the FDCPA applies, filing a proof of claim on a time-barred debt does not violate its provisions. These arguments are addressed in turn.

III.

[6] Atlas does not dispute that it is a debt collector but argues that filing a proof of claim does not constitute debt collection activity regulated by the FDCPA. See 15 U.S.C. § 1692e (prohibiting deceptive or misleading representations "in connection with the collection of any debt"); id. § 1692f (prohibiting unfair or unconscionable means "to collect or attempt to collect any debt"). Instead, Atlas contends that a proof of claim is merely a "request to participate in the bankruptcy process." Appellee's Br. 20.

[7] Determining whether a communication constitutes an attempt to collect a debt is a "commonsense inquiry" that evaluates the "nature of the parties' relationship," the "[objective] purpose and context of the communication [ ]," and whether the communication includes a demand for payment. Gburek v. Litton Loan Servicing LP, 614 F.3d 380, 385 (7th Cir. 2010); see also Olson v. Midland Funding, LLC, 578 Fed.Appx. 248, 251 (4th Cir. 2014) (citing Gburek factors approvingly). Here, the "only relationship between [the parties] [is] that of a debtor and debt collector." Olson, 578 Fed.Appx. at 251. Moreover, the "animating purpose" in filing a proof of claim is to obtain payment by sharing in the distribution of the debtor's bankruptcy estate. See Grden v. Leikin Ingber & Winters PC, 643 F.3d 169, 173 (6th Cir. 2011); 4–501 Collier ¶ 501.01. This fits squarely within the Supreme
Court's understanding of debt collection for purposes of the FDCPA. See Heintz v. Jenkins, 514 U.S. 291, 294, 115 S.Ct. 1489, 131 L.Ed.2d 395 (1995) (explaining that in ordinary English, an attempt to "collect a debt" is an attempt "to obtain payment or liquidation of it, either by personal solicitation or legal proceedings" (quoting Black's Law Dictionary 263 (6th ed. 1990))). Precedent and common sense dictate that filing a proof of claim is an attempt to collect a debt. The absence of an explicit demand for payment does not alter that conclusion, Gburek, 614 F.3d at 382, nor does the fact that the bankruptcy court may ultimately disallow the claim.

[8] Atlas argues that treating a proof of claim as an attempt to collect a debt would conflict with the Bankruptcy Code's automatic stay provision. The automatic stay provides that filing a bankruptcy petition ***528** "operates as a stay" of

"any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case." 11 U.S.C. § 362(a)(6). Atlas argues that if filing a proof of claim were an act to collect debt, then such filing would violate the automatic stay, "an absurd result." Appellee's Br. 21.

[9] **[10]** Atlas's quandary is easily resolved as the automatic stay simply bars actions to collect debt outside of the bankruptcy proceeding. See, e.g., Cent. States, Se. & Sw. Areas Pension Fund v. Basic Am. Indus., Inc., 252 F.3d 911, 918 (7th Cir. 2001) (" '[D]emanding' payment from a debtor in bankruptcy other than in the bankruptcy proceeding itself is normally a violation of the automatic stay"); Campbell v. Countrywide Home Loans, Inc., 545 F.3d 348, 354 (5th Cir. 2008) (explaining that the automatic stay "merely suspends an action to collect the claim outside the procedural mechanisms of the Bankruptcy Code"). The automatic stay helps channel debt collection activity into the bankruptcy process. It does not strip such activity of its debt collection nature for purposes of the FDCPA.

[11] Finally, Atlas argues that filing a proof of claim is not an attempt to collect debt because the proof of claim is directed to the bankruptcy court and trustee rather than to the debtor. However, collection activity directed toward someone other than the debtor may still be actionable under the FDCPA. See, e.g., Sayyed v. Wolpoff & Abramson, 485 F.3d 226, 232–33 (4th Cir. 2007) (finding that FDCPA "plainly" applies to communications made by debt collector to debtor's counsel rather than debtor); Horkey v. J.V.D.B. & Assocs., Inc., 333 F.3d 769, 774 (7th Cir. 2003) (finding that debt collector's phone call to debtor's co-worker was "in connection with the collection of a debt" where purpose of the call was to induce debtor to settle her debt). Although a proof of claim is filed with the bankruptcy court, it is done with the purpose of obtaining payment from the debtor's estate. That the claim is paid by the debtor's estate rather than the debtor personally is irrelevant for purposes of the FDCPA. See 15 U.S.C. §§ 1692e, 1692f (prohibiting the use of deceptive or unfair means to collect "any debt," without specifying a payor).

Accordingly, we find that filing a proof of claim is debt collection activity regulated by the FDCPA.

IV.

We next consider whether filing a proof of claim based on a debt that is beyond the applicable statute of limitations violates the FDCPA. Deciding this issue requires closer examination of the claims process in bankruptcy.

The Federal Rules of Bankruptcy Procedure specify the form, content, and filing requirements for a valid proof of claim. See, e.g., Fed. R. Bankr. P. 3001. A properly filed proof of claim is prima facie evidence of the claim's validity, and the claim is "deemed allowed" unless "a party in interest" objects. 11 U.S.C. § 502. The bankruptcy trustee and debtor are parties in interest who may object.[4] Indeed, the trustee has a statutory duty to "examine ***529** proofs of claims and object to the allowance of any claim that is improper." Id. § 704(a)(5).

If objected to, the Code disallows claims based on timebarred debts. See id. § 502(b)(1) (stating that a claim shall be disallowed if it is "unenforceable against the debtor ... under any agreement or applicable law"); id. § 558 (stating that the bankruptcy estate has "the benefit of any defense available to the debtor ... including statutes of limitation"). As previously noted, debts that are "provided for by the plan or disallowed under section 502" may be discharged. Id. § 1328 (emphasis added).

Appellants contend that the FDCPA should be applied to prohibit debt collectors from filing proofs of claim on time-barred debts. Appellants argue that a timebarred debt is not a "claim" within the meaning of the Bankruptcy Code and that filing claims on time-barred debts is an abusive practice because such claims are seldom objected to and therefore receive payment from the bankruptcy estate to the detriment of the debtor and other creditors. Atlas, meanwhile, argues that a time-barred debt is a valid "claim" and that filing such a claim should not be prohibited because only debts that are treated in the bankruptcy system may be discharged.

A.

[12] The Bankruptcy Code defines the term "claim" broadly to mean a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)(A). By using the "broadest possible definition," the Code "contemplates that all legal obligations of the debtor, no matter

how remote or contingent, will be able to be dealt with in the bankruptcy case," thereby providing the debtor the "broadest possible relief." H.R. Rep. No. 95–595, p. 309 (1977); S. Rep. No. 95–989, p. 22 (1978).

"right to payment" and therefore a "claim" that the holder may file under the Bankruptcy Code.[5]

[17] ***530** Appellants note that a debt must be enforceable to constitute a claim, citing the Supreme Court's statement that "[t]he plain meaning of a 'right to payment' is nothing more nor less than an enforceable obligation." Pa. Dep't of Pub. Welfare v. Davenport, 495 U.S. 552, 559, 110 S.Ct. 2126, 109

Court's statement to mean that a debt must be enforceable in court to be a claim. Indeed, the Bankruptcy Code treats debts that are "contingent" or "unmatured" as claims notwithstanding that such debts are not presently enforceable in court. 11 U.S.C. § 101(5)(A). Furthermore, in Davenport, the Supreme Court found restitution orders to be claims even though "neither the Probation Department nor the victim can enforce restitution obligations in civil proceedings." 495 U.S. at 558, 110 S.Ct. 2126. Instead, such obligations are enforced by the "substantial threat of revocation of probation and incarceration." Id.

It is also notable that while the Bankruptcy Code provides that

[13] **[14]** **[15]** **[16]** "[W]hen the Bankruptcy Code usesU.S.C § 558, the Code nowhere suggests that such debts

L.Ed.2d 588 (1990). However, we do not read the Supreme

time-barred debts are to be disallowed, see, e.g., 11

the word claim ... it is usually referring to a right to payment recognized under state law." Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co., 549 U.S. 443, 451, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007) (quotation omitted). Under Maryland law, the statute of limitations "does not operate to extinguish [a] debt, but to bar the remedy." Potterton v. Ryland Grp., Inc., 289 Md. 371, 424 A.2d 761, 764 (1981) (quotation omitted); see also Higginbotham v. Pub. Serv. Comm'n of Md., 412 Md. 112, 985 A.2d 1183, 1191 (2009) ("[W]e have regarded limitations as not denying the plaintiff's right of action, but only the exercise of the right." (quotation omitted)). Indeed, a stale debt may be revived if the debtor sufficiently acknowledges the debt's existence. Potterton, 424 A.2d at 764; see also FTC, Time–Barred Debts (July 2013), https://www.consumer.ftc.gov/articles/0117time-barred-debts ("Although the [debt] collector may not sue you to collect [a time-barred] debt, you still owe it. The collector can continue to contact you to try to collect.... [and] [i]n some states, if you pay any amount on a time-barred debt or even promise to pay, the debt is 'revived.' ") (saved as ECF opinion attachment). Thus, under Maryland law, a time-barred debt still constitutes a are not to be filed in the first place. Indeed, the Bankruptcy Rules were recently amended to facilitate the assessment of a claim's timeliness by requiring that claims such as the ones at issue in this appeal be filed with a statement setting forth the last transaction date, last payment date, and charge-off date on the account. Fed. R. Bankr. P. 3001, advisory committee notes to 2012 Amendments (discussing filing requirements for claims based on openend or revolving consumer credit agreements). This Rule suggests the Code contemplates that untimely

debts will be filed as claims but ultimately disallowed. Lastly, excluding time-barred debts from the scope of bankruptcy "claims," and thus excluding them from the bankruptcy process, would frustrate the Code's "intended effect to define the scope of the term 'claim' as broadly as possible," 2– 101 Collier ¶ 101.05, and thereby provide the debtor the broadest possible relief. Accordingly, we conclude that when the statute of limitations does not extinguish debts, a time-barred debt falls within the Bankruptcy Code's broad definition of a claim.

B.

[18] Next, we consider whether filing a proof of claim on a time-barred debt violates the FDCPA notwithstanding that the Bankruptcy Code permits such filing. As noted above, the FDCPA has been interpreted to prohibit filing a lawsuit on a time-barred debt. The rationale has been explained as follows:

> As with any defendant sued on a stale claim, the passage of time not only dulls the consumer's memory of the circumstances and validity of the debt, but heightens the probability that she will no longer have personal records detailing the status of the debt. Indeed, the unfairness of such conduct is particularly clear in the consumer context where courts have imposed a heightened standard of care— that sufficient to protect the

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> least sophisticated consumer. Because few unsophisticated consumers would be aware that a statute of limitations could be used to defend against lawsuits based on stale debts, such consumers would unwittingly acquiesce to such lawsuits. And, even if the consumer realizes that she can use time as a defense, she will more than likely still give in rather than fight the lawsuit because ***531** she must still expend energy and resources and subject herself to the embarrassment of going into court to present the defense; this is particularly true in light of the costs of attorneys today.

Kimber v. Fed. Fin. Corp., 668 F.Supp. 1480, 1487 (M.D. Ala. 1987); see also Crawford, 758 F.3d at 1260; Phillips v. Asset Acceptance, LLC, 736 F.3d 1076, 1079 (7th Cir. 2013).[6]

We note at the outset a unique consideration in the bankruptcy context: if a bankruptcy proceeds as contemplated by the Code, a claim based on a time-barred debt will be objected to by the trustee, disallowed, and ultimately discharged, thereby stopping the creditor from engaging in any further collection activity.[7] If the debt is unscheduled and no proof of claim is filed, the debt continues to exist and the debt collector may lawfully pursue collection activity apart from filing a lawsuit. This is detrimental to the debtor and undermines the bankruptcy system's interest in "the collective treatment of all of a debtor's creditors at one time." 1 Norton Bankr. L. & Prac. 3d § 3:9. Clearly, then, when a time-barred debt is not scheduled the optimal scenario is for a claim to be filed and for the Bankruptcy Code to operate as written.

Appellants complain, however, that trustees often lack the time and resources to examine each proof of claim and object to those that are based on time-barred debts. See Appellants' Br. 17–18 (explaining that Maryland has only three Chapter 13 trustees to manage approximately 5,000 cases per year, with approximately 10 proofs of claim filed in each case). Debt collectors like Atlas purportedly take advantage of this by filing claims on stale debts in hopes that the claims will go unnoticed and receive some payment from the bankruptcy estate. When successful, these debt collectors reduce the amount of money available to legitimate creditors and may sometimes cause debtors to pay more into their Chapter 13 plans.

We appreciate the harm that can be wrought if timebarred claims go unnoticed. However the solution, in our view, is not to impose liability under the FDCPA that would categorically bar the filing of such claims, but to improve the Code's administration such that it operates as written.[8] This may be accomplished, for example, by allocating additional resources to trustees or through action of the United States Trustee, who appoints and supervises all Chapter 13 trustees. 28 U.S.C. § 586.

Another consideration that counsels against finding FDCPA liability is that, for ***532** most Chapter 13 debtors, the amount they pay into their bankruptcy plans is unaffected by the number of unsecured claims that are filed. Chapter 13 debtors typically do not enter into 100 percent repayment plans; thus, their unsecured creditors receive only partial payment of their claims, with the remainder being discharged. See 8–1328 Collier ¶ 1328.02 ("Congress clearly contemplated chapter 13 plans paying little or nothing on unsecured debts...."). As additional claims are filed, unsecured creditors receive a smaller share of available funds but the total amount paid by the debtor remains unchanged. Thus, from the perspective of most Chapter 13 debtors, it may in fact be preferable for a timebarred claim to be filed even if it is not objected to, as the debtor will likely pay the same total amount to creditors and the debt can be discharged. See In re Gatewood, 533 B.R. 905, 909 (8th Cir. BAP 2015) (explaining that "debtors have less at stake in claims allowance than they would when facing enforcement of an adverse judgment in a collection action" because the allowance of additional claims would not affect the total amount the debtor would pay).[9]

Various other considerations also differentiate filing a proof of claim on a time-barred debt from filing a lawsuit to collect such debt. First, the Bankruptcy Rules require claims like the ones filed by Atlas to accurately state the last transaction and charge-off date on the account, making untimely claims easier to detect and relieving debtors from the burden of producing evidence to show that the claim is time-barred.[10] Second, a bankruptcy debtor is protected by a trustee and often by counsel who are responsible for objecting to improper claims even if, as Appellants argue, they currently

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do not always do so. Third, unlike a debtor who is unwillingly sued, a Chapter 13 debtor voluntarily initiates the bankruptcy case, diminishing concerns about the embarrassment the debtor may feel in objecting to a stale claim. In sum, the reasons why it is "unfair" and "misleading" to sue on a time-barred debt are considerably diminished in the bankruptcy context, where the debtor has additional protections and potentially benefits from having the debt treated in the bankruptcy process.

Lastly, Appellants concede that a debt collector would not violate the FDCPA by filing a proof of claim on a time-barred debt that the debtor had scheduled and did not designate as "disputed." Appellants explain that scheduling a debt as undisputed is an "invitation to participate" because it provides " 'notice to a creditor that its debt will be paid ... in accordance with the filed proof of claim, claims objection process, and other bankruptcy provisions.' " Appellants' Br. 28 n.14 (quoting Vaughn, 536 B.R. at 678). However, such notice is sent whether a scheduled debt is disputed or not. Moreover, a time-barred debt that is disputed is less likely to be inadvertently allowed. Thus, we see no reason to attach FDCPA liability to a claim filed on a time-barred debt that is scheduled as disputed. Finally, the interests in discharge and collective treatment of claims discussed above convince us that FDCPA liability should ***533** not attach where a debtor fails to schedule a time-barred debt.

We conclude that filing a proof of claim in a Chapter 13 bankruptcy based on a debt that is time-barred does not violate the FDCPA when the statute of limitations does not extinguish the debt.[11]

V.

For the foregoing reasons, we affirm the district court's dismissal of Appellants' FDCPA and MCDCA claims.

AFFIRMED

DIAZ, Circuit Judge, dissenting:

I join Part III of the majority opinion, which concludes that filing a proof of claim is debt-collection activity regulated by the Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. § 1692 et seq. And while I agree that Atlas's time-barred claim is a "claim" under the Bankruptcy Code (as the majority concludes in Part IV.A), I cannot agree that Atlas's alleged conduct is consistent with the FDCPA (or the Maryland Consumer Debt Collection Act (MCDCA),

Md. Code Ann., Com. Law § 14–201 et seq.).[1] Atlas buys the time-barred debt of people in bankruptcy and tries to collect by filing proofs of claim in their bankruptcy proceedings. As Atlas concedes, these claims should fail— the debt is unenforceable in court. But, absent objection, the Bankruptcy Code automatically allows all properly filed claims. 11 U.S.C. § 502. So Atlas plays the odds, representing itself as entitled to part of the debtors' estates. If someone notices the claims and objects, as happened here, Atlas grins sheepishly—"You caught me!"—and admits that the claim is meritless. But if the claim slips through, Atlas uses the bankruptcy court to garner a payoff on unenforceable debts. In my view, this sharp practice is misleading and unfair to debtors and other creditors, and it gives rise to a cause of action under the FDCPA.

Moreover, I would hold that the Bankruptcy Code does not impliedly repeal the FDCPA or preempt the MCDCA. Accordingly, I would vacate the opinion of the district court and remand for further proceedings.

I.

The FDCPA aims to "protect[ ] consumers from abusive and deceptive practices by debt collectors, and ... nonabusive debt collectors from competitive disadvantage." United States v. Nat'l Fin. Servs., Inc., 98 F.3d 131, 135 (4th Cir. 1996). The statute prohibits a wide variety of collection tactics, including the use of "any false, deceptive, or misleading representation or means" of debt collection, 15 U.S.C. § 1692e, and "unfair or unconscionable means to collect or attempt to collect any debt," § 1692f.

Although the FDCPA enumerates specific examples of these broad prohibitions, it does so "[w]ithout limiting [their] general application." Id. For example, "[t]he false representation of ... the character, amount, or legal status of any debt" is a specific violation of the general ban on false, deceptive, or misleading representations. § 1692e(2)(A). But Congress chose not to limit the general prohibitions, to "enable the courts, where appropriate, to proscribe other improper conduct which is not specifically addressed."

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Stratton v. Portfolio Recovery Assocs., LLC, 770 F.3d 443, 450 (6th Cir. 2014) (quoting ***534** S. Rep. No. 95-382 at 4 (1977), as reprinted in 1977 U.S.C.C.A.N. 1695, 1698).

One such court-imposed proscription applies to lawsuits to collect time-barred debt. Crawford v. LVNV Funding, LLC, 758 F.3d 1254, 1259–60 & n.6 (11th Cir. 2014) (citing cases). Such lawsuits raise two major concerns in the consumer context. First, the "least sophisticated consumer"—from whose vantage point we view FDCPA communications, see Russell v. Absolute Collection Servs., Inc., 763 F.3d 385, 394 (4th Cir. 2014)—may be unaware of the existence of a statute-of-limitations defense and may therefore "unwittingly acquiesce to such lawsuits," Kimber v. Fed. Fin. Corp., 668 F.Supp. 1480, 1487 (M.D. Ala. 1987). Second, "the passage of time not only dulls the consumer's memory of the circumstances and validity of the debt, but heightens the probability that [the consumer] will no longer have personal records detailing the status of the debt." Phillips v. Asset Acceptance, LLC, 736 F.3d 1076, 1079 (7th Cir. 2013) (quoting Kimber, 668 F.Supp. at 1487).

These same considerations support recognizing FDCPA liability for filing time-barred claims on unscheduled debts in bankruptcy.[2] Crawford, 758 F.3d at 1260-61. But see Nelson v. Midland Credit Mgmt., Inc., No. 15–2984, 828 F.3d 749, 752, 2016 WL 3672073, at *2 (8th Cir. July 11, 2016) (published opinion) (refusing to "extend[ ] the FDCPA to time-barred proofs of claim" because the Bankruptcy Code's "protections against harassment and deception satisfy the relevant concerns of the FDCPA"). Here, where the proofs of claim provide enough information to determine the debt is time barred, the first consideration is of particular importance. An unsophisticated debtor reviewing a proof of claim may be unaware of the statute-of-limitations defense and— perhaps not appreciating the legal significance of even accurately listed last-transaction and charge-off dates— may nevertheless "acquiesce" to the claims.

While some courts have found the role of the bankruptcy trustee in weeding out time-barred claims critical in distinguishing the bankruptcy context from civil lawsuits, see, e.g., Nelson, 828 F.3d at 751–52, 2016 WL 3672073, at *2, I am not persuaded. At best, a debt collector who files such a claim wastes the trustee's time. At worst, the debt collector catches the trustee asleep at the switch and collects on an invalid claim to the detriment of other creditors and, in many cases, the debtor. In either case, the debt collector misleadingly represents to the debtor that it is entitled to collect through bankruptcy when it is not.

Moreover, there is reason to doubt the efficacy of the trustee as a vigilant steward of the debtor's estate. See, e.g., In re Edwards, 539 B.R. 360, 365 (Bankr. N.D. Ill. 2015) ("Chapter 13 trustees in this district do not object to proofs of claim based on statute of limitations defenses. This is not surprising because objecting to claims based on affirmative defenses would require trustees to examine the details of virtually every unsecured proof of claim, which is simply impracticable."). Indeed, if trustees performed their duties flawlessly, Atlas would have little incentive to engage in its scheme.

Like filing a lawsuit on time-barred debt, Atlas's alleged debt-collection activity in this case is precisely the sort of unfair and misleading practice that Congress intended the courts to recognize as a violation. After the debtors entered bankruptcy, Atlas bought their debts, or rather, ***535** as the bill of sales said, "charged-off receivables." J.A. 58, 132, 143. All of these charged-off debts were more than five-years old, well outside Maryland's threeyear statute of limitations. Nevertheless, Atlas filed proofs of claim to recover the unenforceable debts in the bankruptcy court. The relevance of the statute of limitations was not lost on Atlas, which included the following notice on two of the three proof-of-claim forms it filed: "This proof of claim is being filed pursuant to 11 USC Secs. 101(5), 501(a) and 502(b) as said claim may be outside of the statute of limitations." J.A. 55, 140. Section 502(b) explains that if a claim is objected to, the court will allow the claim "except to the extent that ... such claim is unenforceable against the debtor and the property of the debtor, under any agreement or applicable law." § 502(b)(1). In short, Atlas knew exactly what it was doing—exploiting a weakness in the bankruptcy system and preying on potential error to collect on debts where it should not. The practice subverts a core purpose of bankruptcy by diverting estate assets from the creditors entitled to receive them.

Atlas rather stunningly argues that it is doing a public service: "[B]ut for Atlas' filing of its proofs of claim, those debts would not be subject to discharge and at the conclusion of Appellants' chapter 13 cases, Atlas could restart collection activity with respect thereto so long as it does not otherwise violate the FDCPA." Appellee's Br. at 40. Really? While the statement is literally true, the (unintended) possibility that the time-barred debts will be disallowed and discharged hardly

justifies Atlas's tactics. Moreover, that the debtors did not schedule the debts is some evidence that collection efforts have stopped. And it would not be surprising if they had; the time for enforcement has passed, and the combination of the statute of limitations and the FDCPA seriously limits what a debt collector can do to recover old debts. Ideally, debtors would remember all their old debts, realize they were time barred, schedule them as disputed, and see that they were disallowed. But the FDCPA asks what the least sophisticated consumer would do, not the ideal one. Atlas's conduct games the bankruptcy process; it does not ensure its integrity.

Accordingly, I would hold that Atlas's conduct constitutes a violation of the FDCPA. Such a holding would not impose a great burden on debt collectors. "[A] debt collector is not liable in an action brought under the [FDCPA] if [it] can show 'the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.' " Jerman v. Carlisle, McNellie, Rini, Kramer & Ulrich LPA, 559 U.S. 573, 576, 130 S.Ct. 1605, 176 L.Ed.2d 519 (2010) (quoting 15 U.S.C. § 1692k(c)). Atlas and other debt collectors can avoid FDCPA liability by putting in place a reasonable procedure to screen unscheduled, time-barred claims—if Atlas already has such a procedure, it can prove it in the district court.

II.

Because the majority determines that the FDCPA does not reach Atlas's conduct, it does not address the question whether—if the FDCPA on its own terms would apply to the filing of time-barred claims—the Bankruptcy Code nevertheless precludes such an action. To determine whether two federal statutes are compatible, we employ ordinary statutory interpretation principles. See POM Wonderful LLC v. Coca–Cola Co., ––– U.S. ––––, 134 S.Ct. 2228, 2236, 189 L.Ed.2d 141 (2014). Because the circuits are split on this issue and the arguments have been made extensively on both sides, I explain briefly my ***536** position that the two statutes do not conflict in this instance.

The Second and Ninth Circuits have concluded that the Bankruptcy Code precludes certain FDCPA suits. Simmons v. Roundup Funding, LLC, 622 F.3d 93, 95– 96 (2d Cir. 2010) (rejecting an FDCPA claim brought during the pendency of bankruptcy proceedings for the filing of an inflated proof of claim); Walls v. Wells Fargo Bank, N.A., 276 F.3d 502, 510–11 (9th Cir. 2002) (barring an FDCPA claim for post-bankruptcy debt collection in violation of the discharge order). Both rely on the comprehensive provisions and protections of the Bankruptcy Code to hold that it leaves no room for FDCPA claims. Simmons, 622 F.3d at 96; Walls, 276 F.3d at 510.

The Third, Seventh, and Eleventh Circuits have rejected the notion that FDCPA actions may not be brought in the context of bankruptcy. Johnson v. Midland Funding LLC, 823 F.3d 1334, 1341–42 (11th Cir.2016) (published opinion) (holding that the Bankruptcy Code does not impliedly repeal FDCPA actions for filing proofs of claim on time-barred debt); Simon v. FIA Card Servs., N.A., 732 F.3d 259, 274 (3d Cir. 2013) (permitting an FDCPA claim for the violation of the Bankruptcy Code's subpoena requirements); Randolph v. IMBS, Inc., 368 F.3d 726, 730–31 (7th Cir. 2004) (comparing the FDCPA and Bankruptcy Code and concluding they are compatible).

In the view of these courts, the statutes do not expressly contradict one another, nor are they in "irreconcilable conflict" because "any debt collector can comply with both simultaneously." Randolph, 368 F.3d at 730; accord Johnson, 823 F.3d at 1340–42; Simon, 732 F.3d at 273–74; see also Nat'l Ass'n of Home Builders v. Defs. of Wildlife, 551 U.S. 644, 662, 127 S.Ct. 2518, 168 L.Ed.2d 467 (2007) ("While a later enacted statute ... can sometimes operate to amend or even repeal an earlier statutory provision ..., 'repeals by implication are not favored' and will not be presumed unless the 'intention of the legislature to repeal [is] clear and manifest.' " (third alteration in original) (quoting Watt v. Alaska, 451 U.S. 259, 267, 101 S.Ct. 1673, 68 L.Ed.2d 80 (1981))).

I would side with the view of the Third, Seventh, and Eleventh Circuits, at least on the facts of this case. Atlas does not argue that the Bankruptcy Code expressly bars FDCPA remedies. Instead, it contends the statutes are irreconcilable: "[W]hat [the debtors] allege is prohibited by the FDCPA (the filing of a proof of claim with respect to a 'stale' debt) is expressly permitted by the Bankruptcy Code." Appellee's Br. at 34. But this argument is easily answered: Because the Bankruptcy Code does not obligate a creditor to file a proof of claim, a debt collector such as Atlas can comply with both statutes by not filing unscheduled, time-barred proofs of

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claim. See Johnson, 823 F.3d at 1341–42; Randolph, 368 F.3d at 730.[3]

This conclusion is buttressed by our holding, in a somewhat different posture, that an FDCPA claim may be brought during bankruptcy proceedings. Covert v. LVNV Funding, LLC, 779 F.3d 242, 246–48 (4th Cir. 2015). In Covert, debtors filed suit under the FDCPA and MCDCA after the completion of their bankruptcies, alleging that a creditor had unlawfully filed proofs of claim without a debt-collection license. Id. at 245. We found the claims barred by res judicata because the debtors failed to raise them during the bankruptcy. Id. at 247–48. Because res judicata applies to unraised claims only if they "could have ***537** been adjudicated in an earlier action," id. at 246, we necessarily determined that the debtors "could ... have brought their affirmative claims for damages [under the FDCPA and MCDCA] during the bankruptcy process under Federal Rule of Bankruptcy Procedure 7001(1), which provides that 'a proceeding to recover money or property' may be brought as an adversary action," id. at 248. Similarly, I would hold that the Bankruptcy Code does not preclude or preempt the filing of the FDCPA and MCDCA claims in this case.

III.

Because I believe the debtors state a claim under the FDCPA (and MCDCA), I would reverse and remand for further proceedings.

All Citations

834 F.3d 522

Footnotes

1 "A proof of claim is a form filed by a creditor in a bankruptcy proceeding that states the amount the debtor owes to the creditor and the reason for the debt." Covert v. LVNV Funding, LLC, 779 F.3d 242, 244 n.1 (4th Cir. 2015).

2 Atlas asks the Court to strike any allegation that the loans in this appeal originated with payday lenders. However, the proofs of claim attached to Appellants' complaints indicate that Atlas itself designated the debts "payday." See J.A. 55, 140. Accordingly, we find this fact sufficiently alleged. See Goines v. Valley Cmty. Servs. Bd., 822 F.3d 159, 164–65 (4th Cir.2016) (explaining that on motion to dismiss, courts may consider documents attached to complaint as exhibits).

3 Dubois additionally alleged that Atlas violated the Maryland Consumer Debt Collection Act (MCDCA). Md. Code Ann., Com. Law § 14–201, et seq. The parties do not analyze the MCDCA separately from the FDCPA. Accordingly, neither do we.

4 While the parties do not address the issue, it appears that creditors are also parties in interest who may object to a claim filed by another creditor. See, e.g., Adair v. Sherman, 230 F.3d 890, 894 n.3 (7th Cir. 2000) ("Parties in interest include not only the debtor, but anyone who has a legally protected interest that could be affected by a bankruptcy proceeding. Therefore, if one creditor files a potentially fraudulent proof of claim, other creditors have standing to object to the proof of claim." (citation omitted)); In re Varat Enters., Inc., 81 F.3d 1310, 1317 n.8 (4th Cir. 1996) ("All creditors of a debtor are parties in interest.").

5 Appellants suggest that "by filing proofs of claim on time-barred debt, Atlas is trying to trick debtors into unwittingly reviving the statute [of limitations]." Appellants' Reply Br. 4. Regardless of whether this is Atlas's intent, it is difficult to see how a creditor's filing a proof of claim would constitute acknowledgement of the debt by the debtor, particularly when there is persuasive authority that a debtor does not revive a time-barred debt by listing it in his bankruptcy schedules. See, e.g., Biggs v. Mays, 125 F.2d 693, 697–98 (8th Cir. 1942); In re Povill, 105 F.2d 157, 160 (2d Cir. 1939).

6 The Eleventh Circuit in Crawford is the only court of appeals to hold that filing a proof of claim on a time-barred debt in a Chapter 13 proceeding violates the FDCPA. 758 F.3d at 1256–57. The Eighth Circuit has "reject[ed] extending the FDCPA to time-barred proofs of claim," Nelson v. Midland Credit Mgmt., Inc., No. 15–2984, 828 F.3d 749, 752, 2016 WL 3672073, at *2 (8th Cir. July 11, 2016), and the Second Circuit has broadly held that "filing a proof of claim in bankruptcy court (even one that is somehow invalid) cannot constitute the sort of abusive debt collection practice proscribed by the FDCPA." Simmons v. Roundup Funding, LLC, 622 F.3d 93, 95 (2d Cir. 2010). Other circuits are presently considering the issue. See, e.g., Owens v. LVNV Funding, LLC, No 14–cv–02083, 2015 WL 1826005 (S.D. Ind. Apr. 21, 2015),

appeal docketed, No. 15–2044 (7th Cir. May 13, 2015); Torres v. Asset Acceptance, LLC, 96 F.Supp.3d 541 (E.D. Pa. 2015), appeal docketed, No. 15–2132 (3d Cir. May 13, 2015).

7 By contrast, raising a statute of limitations defense may defeat a lawsuit to collect a time-barred debt but would not extinguish the debt or necessarily prevent collection activity.

8 Indeed, if Appellants are correct that trustees are failing to fulfill their statutory duty to examine and object to improper claims, this is surely producing adverse consequences beyond the context of time-barred debts.

9 As noted above, the FDCPA was enacted in part to protect scrupulous debt collectors from unfair competition. However, bankruptcy creditors are sophisticated entities that may object to improper claims. Thus, we will not invoke the FDCPA solely on their behalf when, as discussed above, there are reasons not to do so on behalf of bankruptcy debtors.

10 There is no allegation that Atlas filed inaccurate proofs of claim. A debt collector who supplies false dates to obscure a claim's staleness may well violate the FDCPA. However, we have no occasion to consider that issue today.

11 In light of this decision, we do not reach Atlas's argument that the Bankruptcy Code precludes the FDCPA and preempts the MCDCA from applying to the filing of a proof of claim.

1 I join the majority in analyzing the FDCPA and MCDCA claims together, as the parties do.

2 As the debtors concede, their case might be different had they scheduled these debts with the bankruptcy court, an action that might be seen as an invitation to a creditor to file a claim.

3 For similar reasons, I would hold that the Bankruptcy Code does not preempt the MCDCA.

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also U.S.Ct. of Appeals 4th Cir. Rule
32.1. United States Court of Appeals,
Fourth Circuit.

In re: Min Sik Kang; Man Sun Kang, Debtors.
Yeon K. **Han**, Creditor–Appellant,
v.
Official Committee of Unsecured Creditors, Creditor,
and
Raymond A. **Yancey**, Trustee–Appellee.

No. 15-2345
|
Submitted: October 5, 2016
|
Decided: November 29, 2016

Appeal from the United States District Court for the Eastern District of Virginia, at Alexandria. Leonie M. Brinkema, District Judge. (1:15–cv–00953–LMB–IDD; 10–18839–RGM; 12–01496–RGM)

Attorneys and Law Firms

Timothy J. McGary, Vienna, Virginia, for Appellant. Todd M. Brooks, Baltimore, Maryland, Bradford F. Englander, Whiteford Taylor & Preston LLP, Falls Church, Virginia, for Appellee.

Before SHEDD, DUNCAN, and FLOYD, Circuit Judges.

Opinion

Affirmed by unpublished per curiam opinion.

Unpublished opinions are not binding precedent in this circuit.

PER CURIAM:

***1** Appellant Yeon **Han** challenges the district court's order affirming the bankruptcy court's grant of summary judgment to Appellee Raymond **Yancey**, the Chapter 11 Trustee in this bankruptcy case. The bankruptcy court entered a declaratory judgment invalidating a purported transfer of ownership interests to **Han** in one of the bankruptcy debtors' LLCs, on the grounds that the transfer violated the LLC's operating agreement. Because we agree that the purported transfer is null and void, we affirm.

I.

A.

Although the ownership transfer at issue here took place in 2009, it has its origins in events tracing back to 2004. In February 2004, Grand Centreville, LLC ("Grand Centreville") was created for the sole purpose of acquiring, developing, and managing a retail shopping center in Centreville, Virginia. At the time of its formation, Grand Centreville had one member: a shell company called Grand Equity, LLC ("Grand Equity"). Grand Equity, in turn, was managed by its sole member, Grand Development, LLC ("Grand Development"), another shell company. Grand Development was wholly owned and managed by the Debtors, Min and Mik Kang.

In June 2005, Grand Centreville refinanced an existing loan and executed a "Deed of Trust, Assignment of Leases and Rents and Security Agreement" ("2005 Deed of Trust"). The 2005 Deed of Trust prohibited specific transactions that could threaten the lender's interests. In particular, (1) Grand Centreville's direct and indirect owners could not transfer more than a 49% interest in Grand Centreville; (2) Grand Centreville could not incur debts outside the ordinary course of business, and (3) Grand Centreville could not encumber the property with additional security interests.

During the course of the refinancing, the Debtors incorporated another entity, Grand Formation, Inc. ("Grand Formation"), which became the managing member of Grand Centreville and acquired a 0.5% ownership interest. Grand Equity (99.5% owner) and Grand Formation (0.5% owner) created a new operating agreement ("the 2005 Operating Agreement"), which listed "Ronnie C. Kim" as an Independent Member. Kim, however, testified that he was never a member of the entity. J.A. 1757–64. The 2005 Operating Agreement incorporated requirements from the 2005 Deed of Trust, including restrictions on the transfer of

ownership interests, incurrence of debts, and encumbrance with additional liens on the property.

As relevant to the Trustee's standing, the State Corporation Commission of Virginia canceled the existence of Grand Equity and Grand Development for nonpayment of annual registration fees as of December 31, 2008. Virginia law provides that when an LLC is canceled, its property "shall pass automatically to its managers, ... members, ... or holders of interest, ... as trustees in liquidation." See Va. Code § 13.1–1050.2(C).[1] Thus, because the Debtors wholly owned Grand Development, which wholly owned Grand Equity, the interests in Grand Centreville held by the canceled LLCs "pass[ed] automatically" to the Debtors, as trustees in liquidation.

***2** On March 16, 2009, the purported transfer at issue here took place ("the 2009 Sale"). In the 2009 Sale, the Debtors agreed to effectively sell 60% of their interests in Grand Centreville and Grand Formation to **Han**[2] and James Sohn,[3] in violation of the terms of the 2005 Operating Agreement. The Debtors also purported to issue a promissory note in favor of **Han** and Sohn, which was secured by a security interest in the shopping center.

B.

On October 19, 2010, the Debtors jointly filed for Chapter 11 bankruptcy. The Office of the United States Trustee appointed the Official Committee of Unsecured Creditors ("the Committee") in early December 2010, which instituted the underlying adversary action to reverse several transactions the Debtors entered into prior to the bankruptcy. In January 2013, the Office of the U.S. Trustee then appointed Appellee **Yancey** as the Chapter 11 Trustee, and he took over the Committee's claims against Sohn and **Han**. The Trustee filed a second-amended complaint, seeking, among other relief not relevant here, a declaration that the 2009 Sale was invalid.

The parties filed cross-motions for summary judgment on this claim, with the Trustee arguing that the 2009 Sale was null and void because it violated the 2005 Operating Agreement. At the summary judgment hearing, the bankruptcy court determined that, if the 2005 Operating Agreement was effective, then the 2009 Sale was void. The court held a trial to resolve the factual dispute as to whether the 2005 Operating Agreement was effective. After trial, the court concluded that the agreement was effective, and that the purported transfer was null and void because it violated the agreement. The district court affirmed the bankruptcy court's ruling invalidating the 2009 Sale.

II.

On appeal, **Han** argues that: (1) the Trustee lacks standing; (2) the 2005 Operating Agreement never became effective and therefore did not govern the 2009 Sale; and (3) even if the 2005 Operating Agreement governed, the 2009 Sale was not null and void.

In reviewing a bankruptcy order, "we apply the same standard of review that the district court applied when it reviewed the bankruptcy court's decision." In re Jenkins, 784 F.3d 230, 234 (4th Cir. 2015) (quoting In re Nieves, 648 F.3d 232, 237 (4th Cir. 2011) (per curiam)). We thus review the bankruptcy court's factual findings for clear error and legal conclusions of both the bankruptcy court and district court de novo. Id.

A.

We begin with the threshold issue of standing. **Han** contends that the Trustee does not have standing to bring the instant claim because the Debtors, in whose shoes the Trustee stands, did not have a direct interest in Grand Centreville, but only an interest in the entities that controlled Grand Centreville—Grand Equity and Grand Development. Thus, according to **Han**, the Trustee is impermissibly attempting to assert the rights of corporate entities rather than rights belonging to the Debtors. This argument is without merit.

A Chapter 11 Trustee has the power to assert the rights of the debtor and creditors, as defined by state law. Steyr– Daimler–Puch of Am. Corp. v. Pappas, 852 F.2d 132, 135 (4th Cir. 1988). Under Virginia law, the property of canceled LLCs "pass[es] automatically" to the managers, members, or holders of interest, who act as trustees in liquidation to distribute the company's assets after the LLC is wound up and all liabilities and obligations are satisfied. Va. Code § 13.1–1050.2(c).

***3** When Grand Development and Grand Equity were canceled in 2008, their interests in Grand Centreville were held in trust by Mr. Kang "as trustee[ ] in liquidation" for himself and Mrs. Kang, the ultimate owners. Id. Because there is no evidence to suggest that the LLCs were anything but pass-through entities with no business to wind up or outstanding debts to pay, the interests they held in Grand Centreville passed directly to the Debtors. Stepping into the Debtors' shoes, the Trustee therefore has standing to pursue its claim that the 2009 Sale is null and void.

B.

Han next argues that because Ronnie Kim never agreed to the 2005 Operating Agreement, it never became effective. See Va. Code § 13.1–1023(B)(1) (providing that "[a]n operating agreement must initially be agreed to by all of the members"). There is no basis for this argument.

It is true that the 2005 Operating Agreement lists Ronnie Kim, together with Grand Formation and Grand Equity, as a member of Grand Centreville. J.A. 1345. However, membership in an LLC is a matter of assent, and a person cannot become a member without agreeing to do so. Cf. Broyhill v. DeLuca (In re DeLuca), 194 B.R. 65 (Bankr. E.D. Va. 1996).[4] Ronnie Kim testified that he had never been a member of Grand Centreville, and had not seen the 2005 Operating Agreement prior to preparing for his deposition, nor even heard of Grand Centreville before then. J.A. 1757–64; J.A. 1823–27. And no testimony or other evidence suggested otherwise. Thus, because Kim was never a member of Grand Centreville, the 2005 Operating Agreement became effective without his agreement.[5]

C.

Finally, **Han** argues that the lower court erred by holding that the transfer was null and void. She contends that violations of the 2005 Operating Agreement only rendered the transaction voidable, which would allow her to raise equitable defenses such as estoppel. See Richard L. Deal & Assoc., Inc. v. Commonwealth, 224 Va. 618, 299 S.E.2d 346, 349 (1983). In particular, she argues that an operating agreement is merely an agreement among its members, and that just as the Debtors could be estopped from denying they had the power to consummate the 2009 Sale, so too can the Trustee. We disagree.

Under Virginia law, an operating agreement binds the parties to the agreement. Mission Residential, LLC v. Triple Net Props., LLC, 275 Va. 157, 654 S.E.2d 888, 891 (2008). And the members can, through the operating agreement, "provide rights to any person, including a person who is not a party to the operating agreement, to the extent set forth in the operating agreement." Va. Code § 13.1–1023(A)(1).

***4** Here, **Han** concedes that the restrictions in the 2005 Operating Agreement were designed to benefit the lender. Appellant's Br. at 13. She also concedes that "[t]he transfer would have violated the transfer of control provisions contained in the 2005 operating agreement." Id. And yet, without citing any authority, she argues that the violations would only give the lender the right to void the 2009 Sale, not render it null and void. Although few courts appear to have spoken on the issue, the courts that have addressed it conclude that actions that violate an LLC's operating agreement are null and void. See, e.g., Kapila v. Deutsche Bank AG (In re Louis J. Pearlman Enters., Inc.), 398 B.R. 59, 65 (Bankr. M.D. Fla. 2008) ("The purported transfer is void and of no effect pursuant to the Operating Agreement.").

We are likewise persuaded that such actions are without legal effect because they exceed the scope of authority conferred by the operating agreement.[6] As the district court recognized, operating agreements define the authority of LLCs, and companies that engage in transactions with an LLC appropriately look to these agreements during the due-diligence process to determine such authority. Actions taken outside the authority conferred by the operating agreement are thus ultra vires and without legal effect.[7] Because there is no dispute that the 2009 Sale violated the 2005 Operating Agreement, it is null and void.

III.

For the foregoing reasons, we affirm the order of the district court.[8]

All Citations

AFFIRMED --- Fed.Appx. ----, 2016 WL 6958438

Footnotes 1 Citations throughout are to the current version of the Virginia Limited Liability Company Act (the "Act"). The Act was amended in 2008, effective April 1, 2009, which resulted in the renumbering of certain provisions related to the cancellation of an LLC's certificate due to nonpayment of registration fees and the process of winding up when such a cancellation occurred. See 2008 Va. Acts 155, ch. 108. No substantive changes were made, and the process now in effect is substantially similar to the process then in effect. See Gen. Tech. Applications, Inc. v. Exro Ltda, 388 F.3d 114, 119– 20 (4th Cir. 2004).

2 Han pleaded guilty on May 15, 2013 before Judge Gerald Bruce Lee in the Eastern District of Virginia to two counts of conspiracy to commit wire fraud, including participation in the creation of false HUD–1 settlement statements in connection with the 2009 Sale. See J.A. 1985.

3 Sohn settled with the Trustee after the bankruptcy court ruled on summary judgment.

4 Han argues that Broyhill does not support the district court's conclusion that "a member [must] have knowledge of and consent [ ] to the membership interest." Appellant's Br. at 11. Although Broyhill does not directly touch on the issue in the present case, the court there did conclude that an entity became a member of an LLC through the assent of all its members. And Han even concedes that she "is not suggesting that Mr. Kim be made an 'involuntary member.' " Appellant's Br. at 12. Her argument that the remaining members' assent to the 2005 Operating Agreement is meaningless without Kim's inclusion is belied by the remaining members' conduct—they never sought Kim's input on decisionmaking or his consent to the 2009 Sale. Simply put, there is no indication they actually intended for Kim to be a true member. Cf. In re Williams, 455 B.R. 485, 496 (Bankr. E.D. Va. 2011).

5 By not arguing it on appeal, Han waived any contention that the 2005 Operating Agreement was not effective because of a missing signature page for Grand Equity. We therefore do not address that argument further.

6 Han's reliance upon News–Register Co. v. Rockingham Pub. Co., 118 Va. 140, 86 S.E. 874 (1915), to argue otherwise is misplaced. First, News–Register Co. pre-dated the existence of LLCs, and concerned two corporations that entered into a partnership agreement. Second, as the court there stated, "[t]he main, indeed the sole, contention in this case centers upon the question whether, under the laws of Virginia, two corporations can form a partnership." Id. at 876. The court concluded that the two corporations could validly form a partnership, and only suggested in dicta that a corporate actor could be estopped from arguing that it was without power to enter into such an agreement after amending its corporate charter to expressly allow it to do so and undertaking the transaction in good faith. Among the other factors making the case inapposite, the transaction here was not undertaken in good faith, but expressly designed to obscure the fact that it violated the 2005 Operating Agreement. See J.A. 1728.

7 As the Trustee argues, the Fifth Circuit's decision in Kinwood Capital Group, LLC v. BankPlus (In re Northlake Dev., LLC), 643 F.3d 448 (5th Cir. 2011), further supports this conclusion. In BankPlus, a minority member of an LLC purported to transfer the LLC's property to another company that he created, without any authority under the LLC's operating agreement. He then used that property as collateral to obtain a loan for his new company, and the bank sought to retain the property after the new company filed for bankruptcy. Relying on an opinion from the Mississippi Supreme Court, the Fifth Circuit concluded that the purported transfer was void and of no legal effect because the minority member, as an agent of the LLC, acted without authority. Id. at 451.

8 We dispensed with oral argument because the facts and legal conclusions are adequately presented in the materials before this court and argument would not aid in the decisional process.

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KeyCite Blue Flag – Appeal Notification
Petition for Certiorari Docketed by PEM ENTITIES LLC v. ERIC M. LEVIN, ET AL., U.S., October 13, 2016

655 Fed.Appx. 971
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 Appeals 4th Cir. Rule 32.1. United States Court of Appeals, Fourth Circuit.

In Re: **Province Grande Olde Liberty**, LLC, a/k/a Silver Deer **Olde Liberty** AA Lots, LLC, Debtor.
Pem Entities, LLC, Appellant,
v.
Province Grande Olde Liberty, LLC, Defendant,
and
Eric M. Levin; Howard Shareff, Creditors–Appellees.

No.
15
–
1669
|
Argued: May 10, 2016
|
Decided: August 12, 2016

Synopsis

Background: Creditors brought adversary proceeding to equitably subordinate or recharacterize certain debt. The United States Bankruptcy Court for the Eastern District of North Carolina, Randy D. Doub, J., 2014 WL 6901052, granted creditors' motion for summary judgment on recharacterization claim, and appeal was taken. The District Court, James C. Dever III, Chief Judge, affirmed. Appeal was taken.

[Holding:] The Court of Appeals held that bankruptcy court's decision to recharacterize the $300,000 contributed by limited liability company's (LLC's) members to pay off earlier loan as equity contribution to debtor was sufficiently supported by evidence.

Affirmed.

West Headnotes (1)

[1] **Bankruptcy**
Weight and sufficiency

Bankruptcy court's decision to recharacterize the $300,000 contributed by limited liability company's (LLC's) members to pay off earlier loan as equity contribution to debtor was sufficiently supported by evidence, including evidence of identity of interest that existed between debtor and LLC, of debtor's inability to obtain financing from any other source, and of parties' failure to observe such formalities as payment schedules, actual interest payments or even a ledger.

Cases that cite this headnote

Appeal from the United States District Court for the Eastern District of North Carolina, at Raleigh. James C. Dever III, Chief District Judge. (5:14–cv–00889–D; 8:13–01563; 8:13–00122)
Affirmed by unpublished per curiam opinion.

Attorneys and Law Firms

Argued: John Arlington Northen, Northen Blue, LLP, Chapel Hill, North Carolina, for Appellant. James C. White, Law Office of James C. White, P.C., Chapel Hill, North Carolina, for Appellees. On Brief: Vicki L. Parrott, John Paul H. Cournoyer, Northen Blue, LLP, Chapel Hill, North Carolina, for Appellant. Michelle M. Walker, Law Office of James C. White, P.C., Chapel Hill, North Carolina, for Appellees.

Before GREGORY, Chief Judge, TRAXLER, Circuit Judge, and Joseph F. ANDERSON, Jr., Senior United States District Judge for the District of South Carolina, sitting by designation.

Opinion

Unpublished opinions are not binding precedent in this circuit.

PER CURIAM:

PEM Entities, LLC ("PEM") appeals the district court's order affirming the bankruptcy court's grant of summary judgment in favor of Eric M. Levin and Howard Shareff ("Appellees"). Specifically, PEM contests the bankruptcy court's recharacterization of certain debt into equity. For the following reasons, we affirm the decision of the district court.

I.

This case arises out of several North Carolina real estate investments involving Howard Jacobsen ("Howard"). Lakebound Fixed Return Fund, LLC ("Lakebound") is a company formed to invest in real estate and provide a fixed, high-yield return to its investors. Lakebound is managed by Howard. Appellees invested $500,000.00 each into Lakebound. Province Grande Olde Liberty, LLC ("Debtor") is an entity formed by Howard for the purpose of acquiring the Olde Liberty Golf and Country Club ("Golf Club"), a golf and residential real estate development in Franklin County, North Carolina. Debtor's membership included Howard, his parents— Stanley and Rhonda Jacobsen—and Robert B. Conaty.

To finance the acquisition of the Golf Club, Debtor obtained $188,000.00 from Lakebound and borrowed $6,465,000.00 from Paragon Commercial Bank ("Paragon"). The transfer of $188,000.00 from Lakebound to Debtor is the subject of ongoing litigation in North Carolina state court and provides a basis for Appellees claims in the underlying bankruptcy proceeding. Specifically, Appellees contend that this transfer was a misappropriation of Lakebound's funds. The $6,465,000.00 loan from Paragon was an arms-length transaction evidenced by a promissory note and secured by a deed of trust on the Golf Club property.

In 2010, Debtor defaulted on the Paragon loan. The following year, Paragon initiated foreclosure proceedings on the real estate security. In an effort to resolve the loans to Debtor and other entities, Howard, Debtor, and several other related entities entered into a settlement agreement with Paragon. Under that agreement, Paragon agreed to sell its $6,465,000.00 loan to a new company, PEM, for the discounted price of $1,242,000.00. PEM is a Delaware company, owned by Stanley Jacobsen— Howard's father, Robert B. Conaty, and an entity owned by trusts established by Stanley Jacobsen for the benefit of his grandchildren ("the Trust").

Importantly, PEM's members did not negotiate the settlement agreement. Rather, Debtor's principals, including Howard Jacobsen, negotiated the agreement that purported to be "in settlement of the Loan." Paragon understood that Debtor's principals had the authority to bind PEM. Further, the settlement agreement bound Paragon to sell the loan to PEM for a fixed price and even included an outline of the financing of the loan's purchase. PEM, however, was not a signor of the settlement agreement.

To fund the loan purchase provision of the settlement agreement, PEM used both equity contributions from its members as well as outside debt. Stanley Jacobsen contributed $130,000.00, Conaty contributed $100,000.00, and the Trust contributed $70,000.00. Together, these three contributions totaled $300,000.00.

PEM relied on financing to assemble the remainder of purchase price. Two individuals, Joseph Deglomini and Joseph Simone (collectively "D&S"), loaned PEM $650,000.00. Additionally, Paragon agreed to loan PEM the final $292,000.00, interest free, needed to complete the settlement. Both loans were secured by Golf Club real estate owned not by PEM, but by Debtor. Finally, PEM agreed to subordinate its position in the security to the loans from both D&S and Paragon.

After the completion of the settlement agreement, Debtor sold some of its property for $462,146.15. From those funds, Debtor paid $240,120.00 directly to Paragon and D&S in partial payment of the loans those entities made to PEM. Debtor transferred $202,087.71 to PEM. Shortly thereafter, PEM "re-advanced" $50,000.00 to Debtor for miscellaneous operating expenses. At no time did PEM or Debtor maintain any ledger or account of the Paragon loan. Several other cash transfers went between Debtor and PEM and Howard sometimes called "loans" and
other times "readvances."

Debtor filed its bankruptcy petition on March 11, 2013. In that filing, it listed PEM's claim at $7,000,000, including the principal from the Paragon loan and accrued interest. Additionally, it listed Appellees as creditors with unknown and disputed claims. Appellees filed claims in the Debtor's bankruptcy proceeding in the amount of $500,000.00 each. They made claims for equitable subordination and recharacterization and also statutory claims for avoidance and recovery of allegedly fraudulent transfers. The parties moved for summary judgment on all claims.

The bankruptcy court granted summary judgment in favor of Appellees on their equitable claim of recharacterization. Specifically, the bankruptcy court concluded that the PEM's loan purchase was, in effect, a settlement and satisfaction of the Paragon loan. The court recharacterized the $300,000.00 portion of the $1,242,000.00 paid by PEM pursuant to the settlement agreement from a debt owed it by Debtor into an equity investment in Debtor. Thus, the court rendered PEM's $7,000,000.00 claim void.

PEM appealed the bankruptcy court's order to the United States District Court for the Eastern District of North Carolina. In its *de novo* review, the district court found the bankruptcy court correctly applied the law and affirmed its judgment. PEM timely filed its Notice of Appeal to this Court.

II.

A.

Recharacterization is well within the broad powers afforded a bankruptcy court. In re: Official Committee of Unsecured Creditors for Dornier Aviation (North America), Inc., 453 F.3d 225 (2006). The Bankruptcy Code establishes a scheme in which contributions to capital receive a lower priority than loans because their nature is that of a fund contributed to meet the obligations of a business and which should be repaid only after all other obligations have been satisfied. Id. at 231. Thus, adjudication under the Bankruptcy Code often requires a determination of whether a particular obligation is debt or equity. Id. When that question is in dispute, the bankruptcy court must make this determination in order to effectuate the priority scheme. Id.

In determining whether or not to recharacterize a claim, a bankruptcy court should apply the eleven factors adopted by this Court in Dornier:

> (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

Id. at 233 (quoting Bayer Corp. v. Masco Tech, Inc. (In re AutoStyle Plastics, Inc.), 269 F.3d 726, 747-48 (6th Cir. 2001)). None of these eleven factors are themselves dispositive. Id. at 234. Rather, their significance varies depending upon the circumstance. Id.

B.

In this case, the bankruptcy court weighed each of the Dornier factors in analyzing the settlement agreement. The court found that all of them weighed in favor of recharacterization. The court emphasized several facts in drawing its conclusion: (1) the naming of the settlement agreement and the fact that it was entered into “in settlement of the loan”; (2) the fact that Debtor's principals negotiated the settlement agreement and note purchase on behalf of PEM; (3) the failure of both Debtor and PEM to observe any formalities such as payment schedules, actual interest payments or even a ledger; (4) Debtor's total reliance on money from PEM to meet expenses and its inability to obtain any other financing; (5) the identity of interests between Debtor and PEM; and (6) that approximately $900,000.00 of the $1,242,000.00 was funded by the pledge of security owned by Debtor. These facts adequately support the bankruptcy court's decision.

PEM contends that the bankruptcy court misapplied the Dornier factors by applying them to the wrong transaction. PEM argues that the bankruptcy court should have limited its analysis to the inception of the Paragon debt rather than to the later settlement agreement. Thus, according to PEM, we should apply the Dornier factors to the situation at the time Paragon made the loan to Debtor. We find this argument unpersuasive.

The bankruptcy court's broad recharacterization power is "integral to the consistent application of the Bankruptcy Code." Dornier, 453 F.3d at 233. "A bankruptcy court's equitable powers have long included the ability to look beyond form to substance." Id. at 233. The recharacterization decision itself rests on the "substance of the transaction" involved. Id. at 232 (emphasis in original).

Here, the settlement agreement is the "substance of the transaction" because it was the basis of the note purchase and gave rise the PEM's claims. The settlement agreement was negotiated and executed by Paragon and Debtor's principals. While PEM notes that it was neither a party to nor a signor of the settlement agreement, Paragon believed Debtor's principals had the authority to bind PEM. Further, the settlement agreement specifically obligated Paragon to sell the loan to PEM. Indeed, the settlement agreement specifically outlined the sources of PEM's funding. It even obligated Paragon to loan PEM $292,000.00. Clearly, PEM knew of, participated in, and consented to those terms. While PEM itself may not have been obligated by the settlement agreement, the settlement agreement certainly obligated Paragon towards PEM.

Thus, the bankruptcy court properly "looked beyond form" to determine that the "substance of the transaction" was in fact the settlement agreement in which Debtor used PEM as an extension of itself to complete what was, in effect, a satisfaction of the Paragon loan. Moreover, the bankruptcy court's application of the Dornier factors adequately supported its recharacterization decision.

C.

PEM challenges several of the bankruptcy court's factual findings. Findings of fact by a bankruptcy court in proceedings within its full jurisdiction are reviewable only for clear error. In re Johnson, 960 F.2d 396, 399 (4th Cir. 1992). Under this standard, we will not reverse a bankruptcy court's factual finding that is supported by the evidence unless that finding is clearly wrong. In re ESA Envtl. Specialists, Inc., 709 F.3d 388, 399 (4th Cir. 2013). We will conclude that a finding is clearly erroneous only if, after reviewing the record, we are left with "a firm and definite conviction that a mistake has been committed." Klein v. PepsiCo, Inc., 845 F.2d 76, 79 (4th Cir. 1988) (citation omitted).

Of the six errors claimed by PEM, none rise to the level of clear error. First, PEM challenges the court's alleged mischaracterization of both the $300,000.00 contribution by the members of PEM and the relief requested by Appellees. The bankruptcy court recharacterized the $300,000.00 portion of the $1,242,000.00 settlement of the $7,000,000.00 claim or in other words, exactly the relief sought by Appellees. The court made a detailed explanation of all the intricate moving parts of this complex dispute. To the extent the court failed to clearly explain each moving piece, it was not due to any mistaken fact, but rather to the unwieldy jargon associated with this type of litigation.

Next, PEM contends the court was in error by stating that Stanley Jacobsen was the sole member of PEM at the time of the settlement agreement. This fact appears to be incorrect as the evidence, discussed above, is that the members of PEM were Stanley Jacobsen, Robert B. Conaty, and the Trust. However, this minor mistake does not rise to the level of clear error. First, the court made this mistake in its recitation of undisputed facts. Secondly, the court obviously understood that PEM's membership included all three members at all relevant times. In its analysis of the first Dornier factor, the court specifically noted that these three members were responsible for the $300,000.00.

PEM's four other claims of errors merely reargue the proper application of the Dornier factors. None constitute clear error.

III.

For the foregoing reasons, the judgment of the district court is **AFFIRMED**.

AFFIRMED

All Citations

655 Fed.Appx. 971

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2016 WL 6591699
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This case was not selected for publication in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1 generally governing citation of judicial decisions issued on or after Jan. 1, 2007. See also U.S.Ct. of App. 5th Cir. Rules 28.7 and 47.5. United States Court of Appeals, Fifth Circuit.

In the Matter of: Exquisite Designs by Castlerock and Company, Incorporated, Debtor
Brad Jones, Appellant
v.
First Bank, Appellee

No. 16–20353
|
Summary Calendar
|
Date Filed: 11/07/2016

Appeal from the United States District Court for the Southern District of Texas, USDC No. 4:16–CV–42

Attorneys and Law Firms

Brad Jones, Pro Se.

Donald Lee Turbyfill, Deborah Colleen Simmons Riherd, Devlin, Naylor & Turbyfill, P.L.L.C., Houston, TX, for Appellee.

Before KING, DENNIS, and COSTA, Circuit Judges.

Opinion

PER CURIAM:[*]

***1** Appellant Brad Jones, proceeding pro se, appeals from the bankruptcy court's denial of his motion to vacate an order lifting the automatic stay. The district court dismissed Jones's appeal because it was untimely. For the following reasons, we REVERSE the district court's dismissal based on untimeliness and AFFIRM the bankruptcy court's denial of Jones's motion to vacate.

FACTUAL AND PROCEDURAL BACKGROUND

In November 2012, Exquisite Designs by Castlerock & Co., Inc. ("Exquisite") filed for Chapter 11 bankruptcy. Appellant Brad Jones is the sole shareholder, president, and director of Exquisite. Appellee First Bank holds promissory notes executed by Exquisite and secured by deed of trust liens on seven properties (the "Mortgaged Properties"). In September 2013, the bankruptcy court confirmed a plan of reorganization. As part of the confirmed plan, Exquisite was to continue payments to First Bank, and First Bank "retain[ed] all deeds of trust liens and security interests in the property."

In September 2014, the bankruptcy court granted a motion to convert the proceedings to a Chapter 7 bankruptcy, and a trustee was appointed. The trustee subsequently moved to abandon multiple properties, including the Mortgaged Properties. In November 2014, the bankruptcy court granted the motion to abandon property.

On February 7, 2015, First Bank moved for relief from the automatic stay pursuant to 11 U.S.C. § 362 in order to foreclose on the Mortgaged Properties. On March 2, 2015, the bankruptcy court entered an "Agreed Order Lifting Automatic Stay of an Act Against Real Property (7 Vacant Lots)" (the "March 2 Order"), which was signed as "Approved and Agreed" by Jones's special appellate counsel.

Subsequently, Jones initiated litigation in Texas state court and filed a notice of lis pendens against the Mortgaged Properties. In August 2015, the state court action was dismissed without prejudice and an agreed order expunging the lis pendens was entered.

On October 5, 2015, Jones filed in the bankruptcy court a "Motion to Vacate [the March 2 Order] Due to Lack of Subject Matter Jurisdiction," in which he argued that the bankruptcy court did not have subject matter jurisdiction over the abandoned Mortgaged Properties at the time that it lifted the automatic stay in its March 2 Order. On the same day, Jones also filed a second notice of lis pendens with Texas. In opposition, First Bank argued that Jones failed to timely appeal the March 2 Order lifting the automatic stay and, therefore, the motion to vacate should be denied as a Federal Rule of Civil Procedure 60 motion. First Bank also included a cross-motion to expunge Jones's second lis pendens and for sanctions prohibiting Jones from filing additional lis pendens against the Mortgaged Properties.

On December 21, the bankruptcy court entered an order (the "December 21 Order") denying Jones's motion to vacate without specifying the basis for its decision. As part of the same order, the bankruptcy court granted First Bank's motion to expunge lis pendens and further found that Jones's motion to vacate and filing of lis pendens violated the automatic stay imposed by 11 U.S.C. § 362 and also violated Federal Rule of Bankruptcy Procedure 9011 as (1) "being presented for the sole and exclusive purpose of harassing First Bank and causing unnecessary delay and causing needless increase in the cost of litigation"; and (2) "asserting claims, defenses and other legal contentions that are not warranted by existing law, and present frivolous arguments unsupported by the Bankruptcy Code or applicable Texas law." Finally, the bankruptcy court enjoined Jones from filing further lis pendens against the Mortgaged Properties.

***2** Jones appealed to the district court. In an oral ruling on May 24, 2016, the district court dismissed Jones's appeal. During the hearing, the district court highlighted the fact that the appeal was not filed until January 2016, but the relief that Jones objected to was granted as part of the March 2 Order. While the district court discussed several other potential grounds for dismissing the appeal, including mootness and lack of standing, it appears that the untimeliness of the appeal was the controlling factor. On May 27, 2016, Jones filed a motion for reconsideration, which was denied by the district court on May 31. Jones timely appealed to this court.

II. DISCUSSION

We first address First Bank's argument that the appeal should be dismissed for lack of jurisdiction. We agree with First Bank that there would not be jurisdiction over the appeal to the extent that it purports to appeal the March 2 Order lifting the automatic stay. In this context, we would also agree with the district court that Jones's notice of appeal filed on January 4, 2016, was untimely as to the March 2 Order lifting the automatic stay and we are without jurisdiction to address that order. *See In re Berman–Smith*, 737 F.3d 997, 1003 (5th Cir. 2013) (per curiam) ("[T]he failure to file a timely notice of appeal in the district court leaves the district court, and this court, without jurisdiction to hear the appeal.").[1] That is because it was not filed within the time limit required by statute. 28 U.S.C. § 158(c)(2).

However, given that Jones is proceeding pro se and that his motion to vacate argued that the bankruptcy court lacked jurisdiction when it made the March 2 Order, we liberally interpret his motion to vacate as a Federal Rule of Civil Procedure 60(b)(4) motion[2] and his appeal as being from the December 21 Order denying his Rule 60(b)(4) motion. *See Grant v. Cuellar*, 59 F.3d 523, 524 (5th Cir. 1995) (per curiam); *In re Bell Family Tr.*, 575 Fed.Appx. 229, 232 (5th Cir. 2014) (per curiam). Under this interpretation, Jones's appeal to the district court from the December 21 Order was timely,[3] and his appeal to this court from the district court's dismissal was also timely. Therefore, Jones's appeal is not untimely such that it would deprive us of jurisdiction, and even though the district court did not reach the merits of the bankruptcy court's denial of Jones's Rule 60(b)(4) motion, under the circumstances of this case, "considerations of judicial economy convince us to address these issues in this appeal." *See In re Texas Extrusion Corp.*, 844 F.2d 1142, 1156–57 (5th Cir. 1988) ("This Court applies the same standard of review. No purpose would be served in remanding this matter back to the district court—the record is adequate for us to exercise the identical review of the order."); *cf. In re Plunk*, 481 F.3d 302, 305 (5th Cir. 2007) ("We may affirm on any grounds supported by the record, even if those grounds were not relied upon by the lower courts.").[4]

***3** But interpreting Jones's motion to vacate as a Rule 60(b)(4) motion does not provide Jones with the relief that he seeks because the bankruptcy court did not err in denying his Rule 60(b)(4) motion. While Rule 60(b) (4) provides that a court may grant relief from a final judgment because "the judgment is void," Rule 60(b) (4) only applies to a limited number of circumstances. *See United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 270, 130 S.Ct. 1367, 176 L.Ed.2d 158 (2010) (" 'A judgment is not void,' for example, 'simply because it is or may have been erroneous.' " (quoting *Hoult v. Hoult*, 57 F.3d 1, 6 (1st Cir. 1995))). Here, the bankruptcy court did not err in denying Jones's Rule 60(b)(4) motion because the March 2 Order does not raise one of the limited situations in which Rule 60(b)(4) can be used to grant relief. Importantly, Jones cannot use a Rule 60(b) (4) motion simply as "a substitute for a timely appeal." *Id.* Jones had notice of, and an opportunity to participate in, the bankruptcy court's March 2 Order lifting the automatic stay. Indeed, Jones's special appellate counsel

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at the time signed the March 2 Order. Jones did not appeal the March 2 Order lifting the automatic by arguing that the bankruptcy court lacked jurisdiction and, thus, cannot now use a Rule 60(b)(4) motion to challenge the bankruptcy court's jurisdiction as a substitute for an untimely appeal from the March 2 Order. *See Picco v. Global Marine Drilling Co.*, 900 F.2d 846, 850 (5th Cir. 1990) (applying the principle of res judicata to a court's prior determination of its own jurisdiction when "the challenging party was before the court when the order in question was entered and had notice of it and had a full and fair, unimpeded opportunity to challenge it, and the court's jurisdiction, by appeal."); *In re Bell Family Tr.*, 575 Fed.Appx. at 232–33 ("A district court's exercise of subject-matter jurisdiction, even if erroneous, is *res judicata* and is not subject to collateral attack through Rule 60(b)(4) if the party seeking to void the judgment had the opportunity previously to challenge jurisdiction and failed to do so."). This is not a situation where there is no "arguable basis" of jurisdiction or where there is a "clear usurpation of power" or "total want of jurisdiction." *See United Student Aid Funds*, 559 U.S. at 271, 130 S.Ct. 1367 (quoting *Nemaizer v. Baker*, 793 F.2d 58, 65 (2d Cir. 1986)); *Picco*, 900 F.2d at 850 & n.6 (quoting *Nemaizer*, 793 F.2d at 65).

Separately, Jones argues that the bankruptcy court improperly granted First Bank's cross-motion to expunge lis pendens. However, Jones did not make this argument on appeal to the district court, and therefore, it is waived. *See In re Bouchie*, 324 F.3d 780, 782 n.6 (5th Cir. 2003) (per curiam). Additionally, Jones argues that First Bank does not have standing as an appellee because it has since sold the Mortgaged Properties to a third party. Even assuming arguendo that it is possible for First Bank to lose standing as an appellee here, we would still reach the same conclusion that the bankruptcy court did not err in denying Jones's motion to vacate. *Cf. Legault v. Zambarano*, 105 F.3d 24, 26 (1st Cir. 1997) ("The issue on this appeal is not the identity of the proper appellee, but whether the district court abused its discretion in awarding sanctions against the appellants.").[5]

III. CONCLUSION

For the foregoing reasons, we REVERSE the district court's dismissal of the appeal based on untimeliness and AFFIRM the bankruptcy court's denial of Jones's motion to vacate.

All Citations

--- Fed.Appx. ----, 2016 WL 6591699

Footnotes

* Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

1 Because an appeal from the March 2 Order lifting the automatic stay would be untimely, we do not need to address First Bank's alternative argument that Jones lacks standing to appeal that order as a "person aggrieved" because he did not appear and object at the hearing on the motion to lift the automatic stay.

2 Federal Rule of Civil Procedure 60(b)(4), which can be used to provide relief when a prior "judgment is void," is made applicable (except in limited situations not relevant here) to bankruptcy proceedings under Federal Rule of Bankruptcy Procedure 9024. In the bankruptcy court, First Bank argued that Jones's motion to vacate should be evaluated pursuant to Rule 60.

3 Jones's notice of appeal to the district court specifically references that he is appealing the December 21 Order.

4 "This court applies the same standard of review to the decisions of a bankruptcy court as does the district court." *In re Plunk*, 481 F.3d at 305. The denial of a Rule 60(b)(4) motion is reviewed de novo. *Callon Petroleum Co. v. Frontier Ins. Co.*, 351 F.3d 204, 208 (5th Cir. 2003).

5 While Jones also raises several other issues on appeal, he has failed to adequately brief how those issues relate to the denial of his motion to vacate. *Cf. In re Bell Family Tr.*, 575 Fed.Appx. at 232 n.1 ("To the extent [the pro se litigant] attempts to raise other issues through this appeal, we do not decide those issues because they were inadequately briefed.").

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841 F.3d 786
United States Court of Appeals, Eighth Circuit.

In re: Casey Drew O'Sullivan, Debtor.
CRP Holdings, A–1, LLC, Appellant,
v.
Casey Drew O'Sullivan, Appellee.

No. 16-1526
|
Submitted: September 22, 2016
|
Filed: November 14, 2016

Synopsis

Background: Chapter 7 debtor moved to avoid judgment lien on exemption-impairment grounds. The United States Bankruptcy Court for the Western District of Missouri, Cynthia A. Norton, J., 2015 WL 3526996, granted motion, and judgment creditor appealed. The United States Bankruptcy Appellate Panel of the Eighth Circuit, Kressel, J., 544 B.R. 407, affirmed, and judgment creditor appealed.

[Holding:] The Court of Appeals, Murphy, Circuit Judge, held that, when ruling on Chapter 7 debtor-husband's motion to avoid, on exemption-impairment grounds, the judicial lien that his judgment creditor was presumed to possess on real property that debtor owned as tenant by the entirety with wife not liable on judgment debt, bankruptcy court's failure to address whether judgment lien, even unenforceable judgment lien, had ever attached to this entireties property necessitated remand.

Vacated and remanded.

West Headnotes (11)

[1] **Bankruptcy**

Conclusions of law; d e novo review

On appeal from decision of the Bankruptcy Appellate Panel (BAP) affirming bankruptcy court's decision, the Court of Appeals acts as second reviewing court of the bankruptcy court's decision, independently applying the same standard of review as the BAP.

Cases that cite this headnote

[2] **Bankruptcy**

Conclusions of law; d e novo review

Court of Appeals reviews the bankruptcy court's interpretation of the law de novo.

Cases that cite this headnote

[3] **Bankruptcy**

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

Chapter 7 provides a means for insolvent debtors to receive a “fresh start” through bankruptcy proceedings. 11 U.S.C.A. § 701 et seq.

Cases that cite this headnote

[4] **Bankruptcy**

Effect as to Securities and Liens

Ordinarily, unless they are avoided, liens and other secured interests survive bankruptcy and may subsequently be levied against a debtor's exempt property, thereby impeding debtor's ability to obtain a fresh start.

Cases that cite this headnote

[5] **Bankruptcy**

Homestead; r esidence

To avoid judgment creditor's alleged lien on his homestead property on exemptionimpairment grounds, Chapter 7 debtor had to establish that creditor's notice of foreign judgment: (1) created an avoidable lien, that (2) affixed on debtor's interest in property, and (3) impaired debtor's claimed homestead exemption in this property. 11 U.S.C.A. § 522(f).

Cases that cite this headnote

[6] **Bankruptcy**

Remand

When ruling on Chapter 7 debtor-husband's motion to avoid, on exemption-impairment grounds, the judicial lien that his judgment creditor was presumed to possess on real property that debtor owned as tenant by the entirety with wife not liable on judgment debt, bankruptcy court's failure to address whether judgment lien, even unenforceable judgment lien, had ever attached to this entireties property necessitated remand so that bankruptcy court could address this preliminary issue in first instance; it was appropriate to allow bankruptcy court to address issue, so as to permit adequate vetting through adversarial process. 11 U.S.C.A. § 522(f).

Cases that cite this headnote

[7] **Bankruptcy**

Liens Avoidable

Even unenforceable liens may be avoided on exemption-impairment grounds. 11 U.S.C.A. § 522(f).

Cases that cite this headnote

[8] **Husband and Wife**

Nature and incidents

Under Missouri law, entireties property is owned by a single entity, the marital community.

Cases that cite this headnote

[9] **Bankruptcy**

Lien avoidance

State law governed whether Chapter 7 debtorhusband possessed an interest in entireties property to which judgment lien could fix, before it fixed, as required for debtor to avoid that lien on exemption-impairment grounds. 11 U.S.C.A. § 522(f).

Cases that cite this headnote

[10] **Bankruptcy**

Lien avoidance

Bankruptcy statute allowing debtor to avoid liens on exemption-impairment grounds is superfluous, and without application, where state law does not allow lien to attach to debtor's exempt property. 11 U.S.C.A. § 522(f).

Cases that cite this headnote

[11] **Bankruptcy**

Judicial liens

When judgment gives rise to unenforceable lien, debtor may move to avoid that lien on exemption-impairment grounds; however, when judgment fails to give rise to any judicial lien, whether enforceable or unenforceable, then bankruptcy statute allowing debtor to avoid liens on exemption-impairment grounds is superfluous and without application. 11 U.S.C.A. § 522(f).

Cases that cite this headnote

***787** Appeal from the United States Bankruptcy Appellate Panel for the Eighth Circuit

Attorneys and Law Firms

Counsel who presented argument on behalf of the appellant was Michael J. Wambolt, of Kansas City, MO. The following attorney appeared on the appellant brief; Neil S. Sader, of Kansas City, MO.

Counsel who presented argument on behalf of the appellee was Norman E. Rouse, of Joplin, MO.

Before RILEY, Chief Judge, MURPHY and SMITH, Circuit Judges.

Opinion

MURPHY, Circuit Judge.

Casey Drew O'Sullivan filed for Chapter 7 bankruptcy and claimed a $15,000 exemption in a homestead he owned as a tenant in the entirety with his wife. O'Sullivan then sought an order from the bankruptcy court avoiding CRP Holdings, A–1, LLC's (CRP) judicial lien on the homestead property to the extent that it impaired his claimed exemption. The bankruptcy court

granted O'Sullivan's motion to avoid CRP's judicial lien, and the bankruptcy appellate panel (BAP) affirmed. See In re O'Sullivan, 544 B.R. 407 (B.A.P. 8th Cir. 2016). Judgment creditor CRP appeals, asserting that its judicial lien is not subject to avoidance. We reverse and remand to the bankruptcy court for further proceedings.

I.

In 2015 CRP obtained a default judgment in Platte County, Missouri circuit court against O'Sullivan and his business in the amount of $765,151.18. O'Sullivan's wife was not included in the judgment, but she and her husband owned property in Barton County, Missouri (the property) as tenants in the entirety. After obtaining the default judgment, CRP filed a notice of foreign judgment with the Barton County circuit court in an attempt to obtain a judicial lien on that property. See Mo. Rev. Stat. § 511.440.

***788** A few months later O'Sullivan filed a voluntary Chapter 7 bankruptcy petition which his wife did not join. O'Sullivan listed the property in his schedules and claimed a $15,000 homestead exemption under both Mo. Rev. Stat. § 513.475 and 11 U.S.C. § 522(b)(3)(B). O'Sullivan simultaneously moved to avoid CRP's purported judicial lien under 11 U.S.C. § 522(f)(1), asserting that the lien impaired his claimed homestead exemption. The bankruptcy court granted the motion, concluding that "CRP's judgment lien—although perhaps not enforceable —certainly affixed upon [O'Sullivan's] home upon CRP's recording of its judgment in Barton County" and therefore impaired O'Sullivan's claimed exemption.

CRP appealed to the BAP, which affirmed the bankruptcy court order. The BAP similarly concluded that "an unenforceable judgment lien arose" on the property held in the entireties and therefore it was "possible for [O'Sullivan] to avoid it under § 522(f)." In re O'Sullivan, 544 B.R. at 413. CRP appeals the BAP's affirmance of the bankruptcy court order avoiding its purported judicial lien.

II.

[1] **[2]** CRP challenges the BAP's conclusion that O'Sullivan could avoid its purported judicial lien on the property. We have jurisdiction to review final decisions of the BAP under 28 U.S.C. § 158(d). When reviewing a decision of the BAP, "we act as a second reviewing court of the bankruptcy court[ ] decision, independently applying the same standard of review as the BAP." In re Lasowski, 575 F.3d 815, 818 (8th Cir. 2009). This appeal turns on the bankruptcy court's interpretation of law which we review de novo. Id.

[3] **[4]** Chapter 7 of the bankruptcy code provides a means for insolvent debtors to receive a "fresh start" through bankruptcy proceedings. In re Thompson, 750 F.2d 628, 630 (8th Cir. 1984). To ensure that debtors have sufficient property to realize fully that fresh start, the code permits debtors to exempt certain property from their bankruptcy estate. See 11 U.S.C. § 522(b). Ordinarily, "liens and other secured interests survive bankruptcy" and can subsequently be levied against a debtor's exempted property, thereby impeding a debtor's ability to obtain a fresh start. Farrey v. Sanderfoot, 500 U.S. 291, 297, 111 S.Ct. 1825, 114 L.Ed.2d 337 (1991); see 11 U.S.C. § 522(c). To shield exempt property from such post bankruptcy collection efforts, 11 U.S.C. § 522(f) (1) provides a mechanism for bankruptcy courts to avoid, or extinguish, secured debts that would otherwise pass through the bankruptcy proceeding.

[5] Under § 522(f)(1), debtors may move to "avoid the fixing of [certain] lien[s] on an interest of the debtor in property to the extent that such lien[s] impair[ ] an exemption to which the debtor would have been entitled under [§ 522(b)]." To avoid the fixing of CRP's purported judicial lien, O'Sullivan therefore had to establish that CRP's notice of foreign judgment had (1) created an avoidable lien under § 522(f)(1), that (2) affixed on O'Sullivan's interest in property exempted under § 522(b), and (3) impaired O'Sullivan's claimed exemption in the property. CRP does not challenge O'Sullivan's claimed $15,000 homestead exemption or the bankruptcy court's impairment analysis. The only contested issues on appeal are whether a judicial lien existed and, if so, whether that lien affixed on O'Sullivan's interest in the property.

[6] Throughout the bankruptcy proceedings and on appeal, neither party has addressed whether CRP had a judicial lien properly subject to avoidance under ***789** § 522(f)(1)(A). Rather, the parties and the bankruptcy court assumed that CRP had a cognizable judicial lien under Missouri law. On appeal, the BAP noted that it had "serious doubts as to whether CRP has a lien at all, much less one that attached or fixed to [O'Sullivan's] interest in property,"

but nonetheless proceeded with the avoidance analysis. In re O'Sullivan, 544 B.R. at 412 n.5. Like the BAP, we have serious doubts as to whether CRP has a lien that affixed onto O'Sullivan's interest in the property. Unlike the BAP, however, we do not think we can definitively rule on the avoidance motion in the absence of such a finding.

[7] The bankruptcy code defines "judicial liens" as liens "obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." 11 U.S.C. § 101(36). Judicial liens are a subset of "liens," which are defined as "charge[s] against or interest[s] in property to secure payment of a debt or performance of an obligation." 11 U.S.C. § 101(37). This definition of "liens" suggests that both unenforceable "charge[s] against" property and enforceable "interest[s] in" property fall within its scope. That interpretation is bolstered by the legislative history of the Bankruptcy Reform Act which itself states that the definition of lien is "very broad" and "includes inchoate liens." S. Rep. No. 95–989, at 25 (1978); H.R. Rep. 95–595, at 312 (1977). We agree with the BAP that unenforceable liens may be avoided under § 522(f)(1).

[8] The question then is whether CRP's notice of foreign judgment created a lien on the property—either enforceable or unenforceable. As the BAP noted, there is a strong argument that it did not. Entireties property "is owned by a single entity, the marital community." Fed. Nat'l Mortg. Ass'n v. Pace, 415 S.W.3d 697, 703 (Mo. Ct. App. 2013). Missouri state court judgments, such as the default judgment CRP obtained against O'Sullivan, are "lien[s] upon the real estate of the person against whom such judgment ... is entered" located within the same county as the judgment. Mo. Rev. Stat. § 511.440 (emphasis added); see also Mo. Rev. Stat. § 511.350. Thus, when CRP filed its notice of foreign judgment, it created a judicial lien on any "real estate" owned by O'Sullivan in Barton County. "Real estate" itself is narrowly defined as an interest in property "liable to be sold upon execution." Mo. Rev. Stat. § 511.010 (emphasis added). Here, because the real estate was held as entireties property, neither spouse arguably had "a separate interest [in that property] subject to execution," and a judgment filed against only one spouse could not "constitute a lien on the [entireties] property." Baker v. Lamar, 140 S.W.2d 31, 35 (Mo. 1940) (emphasis added). There is thus a strong argument that CRP did not obtain any lien on the property.

[9] **[10]** The distinction between an existent but unenforceable lien and a non existent lien is relevant to an avoidance analysis under § 522(f)(1). Whether a debtor "possessed an interest to which [a] lien fixed, before it fixed, is a question of state law." Farrey, 500 U.S. at 299, 111 S.Ct. 1825. Nevertheless, the Supreme Court has defined the term "fixed" in § 522(f) as to "fasten a liability upon." Id. at 296, 111 S.Ct. 1825 (quoting Black's Law Dictionary 637 (6th ed. 1990)). When there is no lien under state law, however, there is nothing to "fasten" upon the property and give rise to an unenforceable lien. As the Tenth Circuit has persuasively concluded, "when state law does not allow a lien to attach to exempt property, § 522(f) is superfluous and without application." In re Sanders, 39 F.3d 258, 262 (10th Cir. 1994).

The distinction between existent but presently unenforceable liens and nonexistent ***790** liens is reflected in the decisions of other appellate courts analyzing § 522(f). Both the Sixth and Tenth circuits have declined to avoid purported judicial liens in cases where a judgment did not give rise under state law to a judicial lien on the exempted property (not even an unenforceable one). While interpreting Colorado law, the Tenth Circuit concluded that the judicial liens at issue "never became liens upon the debtors' homestead" and therefore it was unnecessary to use § 522(f) "to avoid the judgment liens at issue." In re Shafner, No. 94–1602, 1996 WL 98809, at *2 (10th Cir. Mar. 6, 1996); see also In re Sanders, 39 F.3d at 262 (same under Utah law). Similarly, while interpreting Tennessee law, the Sixth Circuit concluded that a debtor could not avoid a judgment creditor's lien because the lien did not attach to the debtor's exempt present possessory interest in the homestead (held with the debtor's spouse as tenants in the entirety). In re Arango, 992 F.2d 611, 615 (6th Cir. 1993). Rather, the debt attached to the debtor's non exempt future interest in the right of survivorship, which was separately included in the bankruptcy estate. Id.

[11] By contrast, the Fifth Circuit permitted a debtor to avoid a purported judicial lien against exempt property because under Texas law the lien at issue "fasten[ed] a liability against the ... homestead—albeit an unenforceable one." In re Henderson, 18 F.3d 1305, 1309 (5th Cir. 1994). In that case, the Fifth Circuit relied on a Texas state court decision holding that a homestead "is not exempt from [a] perfected lien" but rather "is exempt from any seizure attempting to enforce [a] perfected lien." Id. (quoting Exocet Inc. v. Cordes, 815 S.W.2d 350, 352 (Tex. Ct. App. 1991)). We are persuaded by the distinctions drawn by other appellate courts and conclude that where a judgment

gives rise to an unenforceable lien, a debtor may move to avoid that lien under § 522(f). When a judgment fails to give rise to any judicial lien (including an unenforceable lien), however, § 522(f)(1) is superfluous and without application.

In sum, if under Missouri law CRP's notice of foreign judgment failed to give rise to a lien on O'Sullivan's exempt homestead property, the debt would have been dischargeable through the bankruptcy proceedings. O'Sullivan would then not need to resort to § 522(f) to avoid CRP's judgment. Alternatively, O'Sullivan could move to avoid the lien under § 522(f)(1) if CRP's notice of foreign judgment fastened an existent, but presently unenforceable, lien on his exempt property.

We decline to undertake the question of whether there is a cognizable lien under § 522(f)(1) in the first instance. Rather, "[o]ut of prudence, we believe it is appropriate to allow the [bankruptcy] court to address this issue in the first instance," thereby "permit[ting] adequate vetting through the adversarial process." Montin v. Estate of Johnson, 636 F.3d 409, 416 (8th Cir. 2011).

III.

Accordingly the BAP's decision is vacated, and the matter is remanded to the bankruptcy court for it to determine whether CRP has a judicial lien on the property (either enforceable or unenforceable).

All Citations

841 F.3d 786

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

In re New Investments, Inc, Debtor.
Pacifica L 51 LLC, Creditor–Appellant,
v.
New Investments Inc., Debtor–Appellee.

No. 13-36194
|
Argued and Submitted May 3, 2016—Seattle, Washington
|
Filed November 4, 2016

Synopsis

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

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

Reversed and remanded.

Berzon, Circuit Judge, filed dissenting opinion.

West Headnotes (11)

[1] Bankruptcy
Curing defaults

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

Cases that cite this headnote

[2] Bankruptcy
Conclusions of law; d e novo review

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

Cases that cite this headnote

[3] Statutes
Language

When construing statute, court begins with language of statute.

Cases that cite this headnote

[4] Statutes
In general; f actors considered

Statutes
Plain, literal, or clear meaning; a mbiguity

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

Cases that cite this headnote

[5] Statutes
Burden of proof

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

Cases that cite this headnote

[6] Bankruptcy
Curing defaults

While Chapter 11 debtor, by curing default on deed of trust loan, was entitled to return to pre-default conditions, debtor could cure its

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

Cases that cite this headnote

[7] Statutes

Operation and Effect

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

Cases that cite this headnote

[8] Statutes

Relation to plain, literal, or clear meaning; a mbiguity

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

Cases that cite this headnote

[9] Bankruptcy

Curing defaults

While Chapter 11 debtor, by curing default on mortgage loan by means of plan payments, can avoid acceleration or foreclosure, two of the more common consequences of default, debtor does not effectuate a cure merely by paying past due installments of principal at the pre-default interest rate; rather, debtor's “cure” obligations may also include late charges, attorneys' and trustee's fees, and publication and court costs. 11 U.S.C.A. § 1123(d).

Cases that cite this headnote

[10] Bankruptcy

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

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

Cases that cite this headnote

[11] Bankruptcy

In general; n ature and purpose

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

Cases that cite this headnote

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

Attorneys and Law Firms

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

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

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

Dissent by Judge Berzon

OPINION

MURGUIA, Circuit Judge:

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

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

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

The case before us requires us to decide whether *Entz– White* 's rule that a debtor may nullify a loan agreement's requirement of post-default interest remains good law in light of 11 U.S.C. § 1123(d), a provision that Congress enacted after *Entz–White*. Section 1123(d) provides that, if a plan proposes to cure a default, "the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law." 11 U.S.C. § 1123(d). We hold that *Entz–White* 's rule of allowing a curing debtor to avoid a contractual postdefault interest rate in a loan agreement is no longer valid in light of § 1123(d).

I.

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

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

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

II.

[2] [3] [4] [5] We have jurisdiction under 28 U.S.C. § 158(d), and we review the bankruptcy court's interpretation of bankruptcy statutes de novo. *Boyajian v. New Falls Corp. (In re Boyajian)*, 564 F.3d 1088, 1090 (9th Cir. 2009). "When construing the meaning of a statute, we begin with the language of that statute." *Benko v. Quality Loan Serv. Corp.*, 789 F.3d 1111, 1118 (9th Cir. 2015). "If the statutory text is ambiguous, ***1140** we employ other tools, such as legislative history, to construe the meaning of ambiguous terms." *Id.* "A party contending that legislative action changed settled law has the burden of

showing that the legislature intended such a change." *Green v. Bock Laundry Mach. Co.*, 490 U.S. 504, 521, 109 S.Ct. 1981, 104 L.Ed.2d 557 (1989).

III.

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

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

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

11 U.S.C. § 1123(d).

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

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

[7] [8] The fact that Congress had a particular purpose in mind when enacting a statute does not limit the effect of the statute's text, a principle *Entz–White* itself recognized. *See* 850 F.2d at 1341 (noting that a Senate Report for the bill that became 11 U.S.C. § 1124 showed "only that the drafters in the Senate were concerned primarily with defaults resulting in acceleration; it does not show that they meant to confine the section to that situation").

Rather, "[t]he fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning." *Union Bank v. Wolas*, 502 U.S. 151, 158, 112 S.Ct. 527, 116 L.Ed.2d 514 (1991). By its terms, § 1123(d) tells us to look to the promissory note and Washington law to determine what amount New Investments must pay to cure its default. Here, that analysis requires the payment of post-default interest.

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

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

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

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

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

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

IV.

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

REVERSED and REMANDED.

***1143** BERZON, Circuit Judge, dissenting:

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

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

I.

Chapter 11 requires that a debtor's plan of reorganization "provide adequate means for the plan's implementation, such as ... curing or waiving of any default." 11 U.S.C. § 1123(a)(5). In the absence of any statutory definition, this Court held in *Entz–White* that "[c]uring a default" means "returning to pre-default conditions," such that any consequences of the default are "nullified." 850 F.2d at 1340 (quoting *Di Pierro v. Taddeo* (*In re Taddeo*), 685 F.2d 24, 26–27 (2d Cir. 1982)). Because curing a default returns the debtor to the status quo ante, we concluded, "the power to cure under the Bankruptcy Code authorizes a plan to nullify all consequences of default, including avoidance of default penalties such as higher interest." *Id.* at 1342.

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

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

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

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

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

II.

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

Nowhere did the 1994 amendments define "cure a default" or suggest that this Circuit's then-operative definition of "cure" was incorrect. Rather, § 1123(d) indicates which

materials the parties may consult in determining *how* to cure a default. Accordingly, as a result of the 1994 amendments, the *terms* of a cure are circumscribed by the underlying agreement and applicable nonbankruptcy law.

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

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

III.

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

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

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

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

In sum, the pertinent 1994 amendments eliminated the possibility of a "court contrived windfall" for secured creditors. *Id.* Pacifica's challenge to the Bankruptcy Court's confirmation order does not implicate the concern that animated Congress. Like the text of the statute, the legislative history in no way suggests that *Entz–White* 's definition of "cure" is incorrect or was overruled.

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

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IV.

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

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

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

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

All Citations

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Footnotes 1 We reject New Investments's argument that Washington's deed of trust law cannot constitute “applicable nonbankruptcy law” under § 1123(d) because the Bankruptcy Code's automatic stay would prevent foreclosure under Washington law. *See* 11 U.S.C. § 362(a); Wash. Rev. Code Ann. § 61.24.040. This reading would render the phrase “applicable nonbankruptcy law” meaningless because the automatic stay would always trump state law foreclosure provisions, contrary to the statutory text and intent.

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841 F.3d 810
United States Court of Appeals, Ninth Circuit.

In re Gary Lawrence Ozenne, Debtor,
Gary Lawrence Ozenne, Petitioner–Appellant,
v.
Chase Manhattan Bank; Ocwen Loan Servicing; Ocwen Federal Bank FSB, Respondents–Appellees.

No. 11-60039
|
Submitted En Banc September 8, 2016[*] San Francisco, California
|
Filed November 9, 2016

Synopsis
Background: Debtor in Chapter 13 case that was closed several years earlier petitioned for writ of mandamus to compel bankruptcy court to consider his motion for award of sanctions. The United States Bankruptcy Appellate Panel for the Ninth Circuit denied petition, and debtor appealed. The Court of Appeals, Wallace, Senior Circuit Judge, 818 F.3d 514, vacated and remanded.

Holdings: On rehearing en banc, the Court of Appeals, N.R. Smith, Circuit Judge, held that:

[1] debtor who did not timely appeal bankruptcy court'sdenial of his motion for sanctions for alleged violation of automatic stay could not utilize petition for writ of mandamus as substitute for timely appeal, and

[2] requirements for issuance of writ of mandamus werenot satisfied.

Vacated and remanded.

West Headnotes (14)

[1] Federal Courts

Necessity of Objection; P ower and Duty of Court

Generally, federal court must first determine whether it has jurisdiction before reaching the merits of case.

Cases that cite this headnote

[2] Federal Courts

Determination of question of jurisdiction

On appeal, appellant has burden of establishing that appellate court has jurisdiction to hear the appeal.

Cases that cite this headnote

[3] Bankruptcy

Taking and perfecting appeal; t ime; b ond

Deadline to file appeal in bankruptcy case is mandatory and jurisdictional. Fed. R. Banr. P. 8002.

Cases that cite this headnote

[4] Federal Courts

Necessity of Objection; P ower and Duty of Court

Federal court has leeway to choose among threshold grounds for denying audience to a case on the merits.

Cases that cite this headnote

[5] Constitutional Law

Resolution of non-constitutional questions before constitutional questions

Court, as fundamental rule of judicial restraint, must consider nonconstitutional grounds for decision before reaching any constitutional questions.

Cases that cite this headnote

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[6] **Bankruptcy**

Review of Appellate Panel

Court of Appeals first had to address whether the Bankruptcy Appellate Panel (BAP) could, as matter of procedure, consider the debtor's petition for writ of mandamus as substitute for appeal that he never filed prior to expiration of appeals deadline, prior to reaching constitutional question of whether the BAP had jurisdiction to hear debtor's petition under the All Writs Act, if the Court determined that there was no procedural bar. Fed. R. Bankr. P. 8002(a)(1).

Cases that cite this headnote

[7] **Mandamus**

Remedy by Appeal or Writ of Error

Procedurally, petition for writ of mandamus cannot substitute for timely appeal.

Cases that cite this headnote

[8] **Mandamus**

Remedy by Appeal or Writ of Error

Mandamus relief is not available where a party has the option of filing a contemporaneous ordinary appeal.

Cases that cite this headnote

[9] **Mandamus**

Remedy by Appeal or Writ of Error

Appellate court does not have mandamus jurisdiction over a matter subject to direct appeal.

Cases that cite this headnote

[10] **Bankruptcy**

Taking and perfecting appeal; t ime; b ond

Mandamus

Modification or vacation of judgment or order

Chapter 13 debtor who did not timely appeal bankruptcy court's denial of his motion for sanctions for alleged violation of automatic stay could not utilize petition for writ of mandamus as substitute for timely appeal; allowing debtor to seek a writ of mandamus in bankruptcy appellate court in order to obtain relief from an appealable bankruptcy court decision, after time to appeal that decision had passed, would be a plain evasion of appeals deadline that was mandatory and jurisdictional. 11 U.S.C.A. § 362; Fed. R. Bankr. P. 8002(a)(1).

Cases that cite this headnote

[11] **Mandamus**

Nature and scope of remedy in general

Writ of mandamus is one of the most potent weapons in the judicial arsenal.

Cases that cite this headnote

[12] **Mandamus**

Nature and scope of remedy in general

Three conditions must be present prior to issuance of writ of mandamus: (1) party petitioning for the writ must have no other adequate means to attain the relief he desires; (2) petitioner's right to issuance of writ must be clear and indisputable; and (3) issuing court, in exercise of its discretion, must be satisfied that the writ is appropriate under the circumstances.

Cases that cite this headnote

[13] **Mandamus**

Nature and scope of remedy in general

In determining whether mandamus relief is appropriate, court may consider the following factors: (1) whether party petitioning for writ has no other adequate means, such as direct appeal, to attain the relief he or she desires; (2) whether petitioner will be damaged or prejudiced in a way not correctable on appeal; (3) whether district court's order is clearly erroneous as matter of law; (4) whether district court's

order is an oft-repeated error or manifests a persistent disregard of federal rules; and (5) whether district court's order raises new and important problems or issues of law of first impression.

Cases that cite this headnote

[14] Bankruptcy

Taking and perfecting appeal; t ime; b ond

Mandamus

Modification or vacation of judgment or order

Requirements for issuance of writ of mandamus were not satisfied, where relief that debtor sought in petitioning for writ of mandamus was same relief that he could have obtained on appeal, had he filed timely notice of appeal from bankruptcy court's denial of his motion for sanctions for alleged violation of automatic stay. 11 U.S.C.A. § 362.

Cases that cite this headnote

***811** Appeal from the Ninth Circuit, Bankruptcy Appellate Panel, Kirscher, Markell, and Dunn, Bankruptcy Judges, Presiding, BAP No. 11–1208

Attorneys and Law Firms

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John A.E. Pottow, University of Michigan Law School, Ann Arbor, Michigan, for Amicus Curiae John A. E. Pottow.

***812** Before: Sidney R. Thomas, Chief Judge, and Alex Kozinski, Susan P. Graber, M. Margaret McKeown, Richard A. Paez, Marsha S. Berzon, Consuelo M.

Callahan, N. Randy Smith, Paul J. Watford, John B. Owens and Michelle T. Friedland, Circuit Judges.

OPINION

N.R. SMITH, Circuit Judge:

This matter comes before the en banc court on an appeal, filed by Gary Ozenne, from the Ninth Circuit Bankruptcy Appellate Panel ("BAP"). The BAP determined that it had jurisdiction to hear Ozenne's petition for a writ of mandamus and then denied the petition. However, the BAP did not have jurisdiction to hear Ozenne's petition. Mandamus was not available to Ozenne because he filed the petition as a substitute for filing the timely appeal required by the Federal Rules of Bankruptcy Procedure. Ozenne's failure to file a timely appeal jurisdictionally barred the BAP from considering the petition for writ of mandamus.

FACTUAL AND PROCEDURAL BACKGROUND

A. Ozenne's Initial Bankruptcy Petition

The history of this litigation is lengthy. This case—Ozenne's fifth chapter 13 bankruptcy—was filed on May 17, 2001, in the United States Bankruptcy Court for the Central District of California. At that time, Chase Manhattan Bank, Ocwen Loan Servicing, and Ocwen Federal Bank FSB ("the Financial Institutions") held and/or serviced a mortgage on Ozenne's home, and they were scheduled to foreclose on the mortgage on May 17, 2001. However, Ozenne filed for bankruptcy that same day in an attempt to stop the foreclosure. Ozenne was unable to make his scheduled payments under this fifth chapter 13 plan. Thus, on a motion to dismiss filed by the trustee, the bankruptcy court dismissed the case in March 2002. Ozenne filed for chapter 13 bankruptcy at least two more times, and both cases were dismissed. The Financial Institutions finally

successfully foreclosed on Ozenne's mortgage on July 31, 2002.

B. Ozenne's First Attempt to Reopen the Case

In February 2003, Ozenne filed a motion in the bankruptcy court to reopen this fifth bankruptcy. Ozenne alleged that his creditors sold his residence unlawfully in violation of an automatic stay. The bankruptcy court denied the motion on March 28, 2003. The United States District Court for the Central District of California affirmed on August 5, 2003. We affirmed on June 24, 2005, *Ozenne v. Chase Manhattan Bank (In re Ozenne)*, 137 Fed.Appx. 62 (9th Cir. 2005) (unpublished), and the Supreme Court denied certiorari, *Ozenne v. Chase Manhattan Bank*, 546 U.S. 1178, 126 S.Ct. 1350, 164 L.Ed.2d 62 (2006).

C. Ozenne's Second Attempt to Reopen the Case

In April 2007, Ozenne filed another motion in the bankruptcy court. This time he sought to set aside the bankruptcy court's judgment under Federal Rule of Civil Procedure 60 and sought damages under 11 U.S.C. § 362. Section 362(k) permits a debtor to recover damages in the case of a violation of a bankruptcy stay. The bankruptcy court returned the motion to Ozenne, stating that the case had been dismissed and that the court no longer had jurisdiction to consider the case.[1]

***813** Ozenne appealed to the district court, contesting the bankruptcy court's determination that it lacked jurisdiction over the case. The district court affirmed on the ground that the Rule 60 motion was filed four years too late. Ozenne appealed the ruling to this court, and we affirmed on June 30, 2009. However, before we ruled on the appeal, Ozenne filed a petition for writ of mandamus here in February 2009. The petition asserted that Chase Manhattan Bank "unlawfully issued a trustees [sic] deed" for his property to a third party "in violation of the bankruptcy automatic stay" and sought "a hearing under 11 [U.S.C. §] 362(k) ... to determine the damages caused by this violation of law." We denied the petition, and the Supreme Court denied Ozenne's petition for writ of certiorari. *Ozenne v. Chase Manhattan Bank*, 559 U.S. 943, 130 S.Ct. 1510, 176 L.Ed.2d 121 (2010).

D. Ozenne's Third Attempt to Reopen the Case

On November 13, 2009, Ozenne filed another motion for sanctions with the bankruptcy court for violations of 11 U.S.C. § 362(a). On January 27, 2011, the bankruptcy court again denied the motion and returned it to Ozenne, reiterating that the case was closed and that the court lacked jurisdiction to hear the motion.[2]

Ozenne never appealed this denial. Instead, on May 2, 2011, he filed a petition for writ of mandamus with the BAP, asking the BAP to order the bankruptcy court to hold a trial or hearing on the alleged § 362(a) violations. On May 20, 2011, without receiving a response from the Financial Institutions, the BAP determined that it had the authority to issue a writ of mandamus but denied the petition because Ozenne "ha[d] not met the burden to establish that a writ of mandamus should be issued." Ozenne filed his notice of appeal to this court on June 20, 2011. That appeal is currently before us.

The Financial Institutions claim they received no notice of the petition, the BAP's decision, or the appeal. When the Financial Institutions had not filed a response by October 24, 2012, this court issued a notice, informing them that they had fourteen days to file an answering brief. Despite this notice, the Financial Institutions did not appear until August of 2015. After allowing the Financial Institutions to file a late brief, a three-judge panel issued an opinion on March 25, 2016, vacating the BAP's order. The majority held that the BAP lacked jurisdiction under the All Writs Act, because the BAP, established by the circuit judicial council pursuant to 28 U.S.C. § 158(b)(1), was not "established by Act of Congress." *Ozenne v. Chase Manhattan Bank (In re Ozenne)*, 818 F.3d 514, 515 (9th Cir. 2016) (quoting 28 U.S.C. § 1651(a)). Accordingly, the panel "remand[ed] the case with instructions to dismiss the petition for lack of jurisdiction." *Id.* at 522. Judge Bybee "concurr[ed] in the judgment but vigorously disagree[d] with" the majority's decision to raise constitutional issues when the appeal could have been decided on alternate grounds, and also disagreed with the majority's characterization of the BAP. *Id.* (Bybee, J., dissenting).

Thereafter, we asked the parties to submit briefs as to whether the case should be heard en banc. A majority

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of non-recused active judges ultimately voted to rehear the case en banc.[3]

***814 DISCUSSION**

We have jurisdiction to hear Ozenne's appeal from the BAP. *See* 28 U.S.C. § 158(d)(1). We address whether the BAP had jurisdiction to hear Ozenne's mandamus petition.

[1] [2] [3] Generally, a federal court must first determine whether it has jurisdiction before reaching the merits of a case. *Sinochem Int'l Co. v. Malaysia Int'l Shipping Corp.*, 549 U.S. 422, 430–31, 127 S.Ct. 1184, 167 L.Ed.2d 15 (2007). On appeal, the appellant has the burden of establishing that the appellate court has jurisdiction to hear the case. *Melendres v. Maricopa Cty.*, 815 F.3d 645, 649 (9th Cir. 2016). The deadline to file an appeal is "mandatory and jurisdictional." *Browder v. Dir., Dep't of Corr.*, 434 U.S. 257, 264, 98 S.Ct. 556, 54 L.Ed.2d 521 (1978) (internal quotation marks and citation omitted); *see also Melendres*, 815 F.3d at 649 ("[W]e are not at liberty to overlook a defect with the notice of appeal no matter how compelling an appellant's argument may be."). This rule also applies to federal bankruptcy appeals. *Anderson v. Mouradick (In re Mouradick)*, 13 F.3d 326, 327–28 (9th Cir. 1994) ("[T]he untimely filing of a notice of appeal deprives the appellate court of jurisdiction to review the bankruptcy court's order.").

A party to a bankruptcy proceeding has fourteen days to appeal a bankruptcy judge's order. Fed. R. Bankr. P. 8002(a)(1). Ozenne's November 2009 motion asked the bankruptcy court "to conduct a hearing or a trial with a jury of peers under 11 [U.S.C. §] 362(k), to legally inspect these violations of bankruptcy law, and determine damages." Ozenne had the right to appeal the bankruptcy court's January 27, 2011 decision that it lacked jurisdiction to hear this motion either to the district court or to the BAP. *See* Fed. R. Bankr. P. 8003; 28 U.S.C. § 158(a). Ozenne did not appeal the decision within the mandatory and jurisdictional time limit.[4] Therefore, the BAP lacked jurisdiction to consider any appeal of this decision.

Instead of filing a timely appeal, Ozenne filed a mandamus petition with the BAP on May 2, 2011. Ozenne's petition sought "an order from [the BAP] ordering a trial or hearing for the violations of law under 11 [U.S.C. §] 362." Thus, Ozenne's mandamus petition sought exactly what a proper appeal of the bankruptcy court's January 2011 order would have sought: relief from the bankruptcy court's determination that it did not have jurisdiction to hear the case. The mandamus petition sought the precise relief that would have been available in an appeal had Ozenne filed a timely notice of appeal. We must then determine whether such a writ of mandamus can substitute for a timely appeal.

[4] [5] [6] We acknowledge that "a federal court has leeway 'to choose among threshold grounds for denying audience to a case on the merits.' " *Sinochem*, 549 U.S. at 431, 127 S.Ct. 1184 (quoting *Ruhrgas AG v. Marathon Oil Co.*, 526 U.S. 574, 585, 119 S.Ct. 1563, 143 L.Ed.2d 760 (1999)). However, as a "fundamental rule of judicial restraint," we "must consider nonconstitutional grounds for decision" before "reaching any constitutional questions." *Jean v. Nelson*, 472 U.S. 846, 854, 105 S.Ct. 2992, 86 L.Ed.2d 664 (1985) ***815** (citations and internal quotation marks omitted). Accordingly, we must first address whether the BAP had jurisdiction to hear Ozenne's appeal as a matter of procedure and only reach the constitutional question of whether the BAP had jurisdiction to hear Ozenne's appeal under the All Writs Act if we determine there is no procedural bar.

[7] [8] [9] [10] Procedurally, a writ of mandamus cannot substitute for a timely appeal. *Calderon v. U.S. Dist. Court for Cent. Dist. of Cal.*, 137 F.3d 1420, 1421 (9th Cir. 1998) (dismissing a mandamus petition for lack of jurisdiction where the petitioner had filed it after the deadline to file a notice of appeal, and explaining that "[b]ecause [the petitioner] could have obtained review of the district court's order through an ordinary appeal, mandamus is not available"). Thus, where a party has the option of filing "a contemporaneous ordinary appeal," mandamus relief "is not available." *Herrington v. Sonoma Cty.*, 706 F.2d 938, 940 (9th Cir. 1983) (citing *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 8 n.6, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983)). In short, an appellate court does not have "mandamus jurisdiction over a matter subject to direct appeal." *Diamond v. U.S. Dist. Court for Cent. Dist. of Cal.*, 661 F.2d 1198, 1198 (9th Cir. 1981) (order) (citation omitted) (refusing to construe a mandamus petition as a notice of appeal when the petitioner filed the mandamus petition after the deadline for filing a notice of appeal had passed); *see also Roche v. Evaporated Milk Ass'n*, 319 U.S. 21, 26, 63 S.Ct. 938, 87 L.Ed. 1185 (1943) ("[Mandamus]

may not appropriately be used merely as a substitute for the appeal procedure prescribed by the statute."); *Ex parte Rowland*, 104 U.S. 604, 617, 26 L.Ed. 861 (1881) ("The general principle which governs proceedings by *mandamus* is, that whatever can be done without the employment of that extraordinary remedy, may not be done with it. It only lies when there is practically no other remedy." (emphasis in original)). To allow a party to seek a writ of mandamus in an appellate court in order to obtain relief from an appealable district court decision—after the time to appeal that decision has passed—would be a plain evasion of rules that are, as noted above, mandatory and jurisdictional.

[11] [12] [13] [14] Finally, a writ of mandamus could not issue. The writ of mandamus is "one of 'the most potent weapons in the judicial arsenal.' " *Cheney v. U.S. Dist. Court for D.C.*, 542 U.S. 367, 380, 124 S.Ct. 2576, 159 L.Ed.2d 459 (2004) (quoting *Will v. United States*, 389 U.S. 90, 107, 88 S.Ct. 269, 19 L.Ed.2d 305 (1967)). Accordingly, three conditions must be present before a writ of mandamus may issue. *Id.* "First, 'the party seeking issuance of the writ [must] have no other adequate means to attain the relief he desires.' " *Id.* (alteration in original) (quoting *Kerr v. U.S. Dist. Court for N. Dist. of Cal.*, 426 U.S. 394, 403, 96 S.Ct. 2119, 48 L.Ed.2d 725 (1976)). Second, the petitioner's right to issuance of the writ must be "clear and indisputable." *Id.* at 381, 124 S.Ct. 2576 (quoting *Kerr*, 426 U.S. at 403, 96 S.Ct. 2119). "Third, even if the first two prerequisites have been met, the issuing court, in the exercise of its discretion, must be satisfied that the writ is appropriate under the circumstances." *Id.* (citation omitted). The Ninth Circuit has also articulated the following five factors, laid out in *Bauman v. U.S. District Court*, 557 F.2d 650 (9th Cir. 1977), in determining whether mandamus relief is appropriate:

> (1) The party seeking the writ has no other adequate means, such as a direct appeal, to attain the relief he or she desires. (2) The petitioner will be damaged or prejudiced in a way not correctable ***816** on appeal. (This guideline is closely related to the first.) (3) The district court's order is clearly erroneous as a matter of law. (4) The district court's order is an oft-repeated error, or manifests a persistent disregard of the federal rules. (5) The district court's order raises new and important problems, or issues of law of first impression.

United States v. U.S. Dist. Court for Dist. of Nev. (In re United States), 791 F.3d 945, 955 & n.7 (9th Cir. 2015) (quoting *Bauman*, 557 F.2d at 654–55).

Although Ozenne fails to satisfy any of the conditions for mandamus relief, we need only discuss the first condition in determining whether a writ could issue: The party seeking issuance of the writ must have no other adequate means to attain the desired relief. The first condition is "designed to ensure that the writ will not be used as a substitute for the regular appeals process." *Cheney*, 542 U.S. at 380–81, 124 S.Ct. 2576 (citing *Ex parte Fahey*, 332 U.S. 258, 260, 67 S.Ct. 1558, 91 L.Ed. 2041 (1947)). Because appellate review of the bankruptcy court's order dismissing the motion for sanctions was available to Ozenne, a writ of mandamus granting him relief from that order could not issue.

CONCLUSION

Ozenne could have appealed the bankruptcy court's January 2011 decision. But he did not. Instead Ozenne waited for the notice of appeal deadline to pass and then filed a mandamus petition seeking precisely the same relief he would have sought in an appeal. In effect, then, despite its label, the petition was an untimely appeal. The BAP would not have had jurisdiction to consider the untimely appeal. *See In re Mouradick*, 13 F.3d at 327. As a writ of mandamus cannot substitute for a timely appeal, the BAP also did not have jurisdiction to consider the appeal labeled as a mandamus petition. *See Calderon*, 137 F.3d at 1422; *Diamond*, 661 F.2d at 1198. Ozenne will not be permitted to use mandamus to circumvent the jurisdictional requirement that he file a timely appeal. The BAP should have dismissed the petition for that reason.[5]

We vacate the BAP's May 20, 2011, Order and remand the case with instruction to dismiss the petition for lack of jurisdiction. Parties shall bear their own costs for the appeal.

VACATED and REMANDED.

All Citations

841 F.3d 810, 63 Bankr.Ct.Dec. 85

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Footnotes

[*] The panel unanimously concludes this case is suitable for decision without oral argument. *See* Fed. R. App. P. 34(a)(2).

[1] These documents do not appear on the bankruptcy court docket but were submitted in the parties' excerpts of record.

[2] This denial also does not appear on the bankruptcy court's docket but was submitted in the excerpts of record.

[3] *Ozenne v. Chase Manhattan Bank (In re Ozenne)*, 828 F.3d 1012 (9th Cir. 2016) (order granting rehearing en banc). [4] Ozenne has stated that he did not become aware of the bankruptcy court's order until February 14, 2011, a few days after the fourteen-day deadline to appeal had passed. However, Ozenne still had time to file a motion for extension of time to appeal. Fed. R. Bankr. P. 8002(d)(1)(B) (permitting a party to file a motion to extend the time to appeal, so long as the motion is filed within twenty-one days of the fourteen-day deadline and the party shows excusable neglect). Ozenne failed to file such a motion; rather, he filed nothing until his petition for writ of mandamus.

[5] Because of the ground on which we resolve this appeal, we need not and do not decide whether the BAP had consensual jurisdiction to hear Ozenne's mandamus petition, whether the BAP required consensual jurisdiction to hear it, or whether the BAP had authority to entertain petitions under the All Writs Act.

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2016 WL 6936595
United States Court of Appeals, Ninth Circuit.

In re Yellowstone Mountain Club, LLC, Debtor,
Timothy L. Blixseth, Plaintiff-Appellant,
v.
Stephen R. Brown; Garlington, Lohn & Robinson, PLLP, Defendants-Appellees.

No. 14-35363
|
Argued and Submitted February 25, 2016, Pasadena, California
|
Filed November 28, 2016

Synopsis

Background: Creditor moved for authority to sue chairperson of unsecured creditors' committee in federal district court. The United States Bankruptcy Court for the District of Montana, Ralph B. Kirscher, J., 2013 WL 1099155, denied motion, and creditor appealed. The District Court affirmed, and creditor appealed.

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

[1] *Barton* doctrine applies to members of unsecured creditors' committee who are sued for acts performed in their official capacities;

[2] *Barton* doctrine did not protect attorney appointed as chairperson of unsecured creditors' committee for allegedly improper advice that he gave to estate creditor prior to his appointment to committee;

[3] bankruptcy court did not abuse its discretion indenying *Barton* motion for leave to sue chairperson of unsecured creditors' committee in district court for actions that he took in his official capacity as committee chairperson;

[4] bankruptcy court, even as non-Article-III court, hadconstitutional authority to decide *Barton* claims against chairperson of unsecured creditors' committee; but

[5] attorney's position as chairperson of unsecuredcreditors' committee did not entitle him to derivative judicial immunity for all of his actions as chairperson.

Affirmed in part, and vacated and remanded in part.

West Headnotes (17)

[1] **Bankruptcy**
Leave to sue

Under *Barton* doctrine, plaintiffs must obtain authorization from bankruptcy court before initiating suit in another forum against certain officers appointed by the bankruptcy court for actions those officers have taken in their official capacities.

Cases that cite this headnote

[2] **Bankruptcy**
Leave to sue

District court in the same judicial district is considered to be "another forum," in which plaintiff cannot bring suit against officer appointed by bankruptcy court for actions taken in his or her official capacity without bankruptcy court's permission.

Cases that cite this headnote

[3] **Bankruptcy**
Discretion

Court of Appeals reviews for abuse of discretion the bankruptcy court's denial of leave to sue an officer that the court appointed pursuant to *Barton* doctrine. Cases that cite this headnote

[4] **Bankruptcy**
Conclusions of law; d e novo review

Court of Appeals reviews de novo whether bankruptcy court had authority to resolve claims on the merits.

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Cases that cite this headnote

[5] **Bankruptcy**
Leave to sue

Barton doctrine traditionally applies to actions against receivers and bankruptcy trustees, and touchstone of *Barton* inquiry is whether suit challenges acts done in receiver's or trustee's official capacity and within his authority as an officer of court.

Cases that cite this headnote

[6] **Bankruptcy**
Leave to sue

Barton doctrine applies to members of unsecured creditors' committee who are sued for acts performed in their official capacities, and any such suit against a committee member must be brought in bankruptcy court, or in another court only with the express permission of bankruptcy court.

Cases that cite this headnote

[7] **Bankruptcy**
Leave to sue

Barton doctrine did not protect attorney appointed as chairperson of unsecured creditors' committee for allegedly improper advice that he gave to estate creditor prior to his appointment to committee, and attorney could be sued for such alleged misconduct, which was prior to and unrelated to his position on committee, in a forum other than bankruptcy court without bankruptcy court's permission.

Cases that cite this headnote

[8] **Bankruptcy**
Leave to sue

Attorney who was appointed as chairperson of unsecured creditors' committee could be sued in a forum other than bankruptcy court for conduct related to his actions after he was appointed the committee chair only with bankruptcy court's permission.

Cases that cite this headnote

[9] **Bankruptcy**
Leave to sue

In deciding whether to grant permission to sue a court-appointed officer in another forum for actions taken in his or her official capacity, bankruptcy courts consider the following factors as bearing on the *Barton* analysis: (1) whether the acts complained of relate to the carrying on of business connected with property of the estate, (2) whether the claims concern the actions of officer while administering the estate, (3) whether officer is entitled to quasi-judicial or derived judicial immunity, (4) whether the plaintiff seeks personal judgment against the officer, and (5) whether the claims seek relief for breach of fiduciary duty, through either negligent or willful conduct; satisfaction of even one of these factors may be basis for the bankruptcy court to retain jurisdiction.

Cases that cite this headnote

[10] **Bankruptcy**
Leave to sue

Bankruptcy court did not abuse its discretion in denying *Barton* motion for leave to sue chairperson of unsecured creditors' committee in district court for actions that he took in his official capacity as committee chairperson, where movant sought a personal judgment against this chairperson.

Cases that cite this headnote

[11] **Bankruptcy**
Claims or proceedings against estate or debtor; relief from stay

Any *Stern* problem posed by bankruptcy court's entry of final judgment on legal malpractice claims was not cured by plaintiff's alleged consent to have claims tried before non-Article-III court, where plaintiff never expressly consented to have claims tried in bankruptcy court, and where plaintiff, at hearing on his *Barton* motion for leave to proceed in district court, maintained that he had right to litigate his legal malpractice claims against chairperson of

unsecured creditors' committee in district court. U.S. Const. art. 3, § 1 et seq.

Cases that cite this headnote

[12] **Bankruptcy**

Claims or proceedings against estate or debtor; r elief from stay

Any *Stern* problem posed by bankruptcy court's entry of final judgment on legal malpractice claims against chairperson of unsecured creditors' committee was not cured by district court's alleged de novo review; while district court claimed to conduct a de novo review, it did not undertake a meaningful claim-by-claim analysis and did not afford plaintiff anything close to an independent decision by Article III adjudicator. U.S. Const. art. 3, § 1 et seq.

Cases that cite this headnote

[13] **Bankruptcy**

Bankruptcy Jurisdiction

Bankruptcy courts, as non-Article-III courts, lack constitutional authority to adjudicate common law causes of action that neither derive from nor depend upon any agency regulatory regime. U.S. Const. art. 3, § 1 et seq.

Cases that cite this headnote

[14] **Bankruptcy**

Bankruptcy Jurisdiction

Bankruptcy courts, as non-Article-III courts, lack constitutional authority to decide common law claims that have no connection to the bankruptcy estate other than that they happen to be assets of the estate. U.S. Const. art. 3, § 1 et seq.

Cases that cite this headnote

[15] **Bankruptcy**

Claims or proceedings against estate or debtor; r elief from stay

Bankruptcy court, even as non-ArticleIII court, had constitutional authority to decide *Barton* claims against chairperson of unsecured creditors' committee for actions taken in his official capacity; such claims necessarily stemmed from the bankruptcy itself. U.S. Const. art. 3, § 1 et seq.

Cases that cite this headnote

[16] **Bankruptcy**

Conclusions of law; d e novo review

Court of Appeals would review de novo the bankruptcy court's dismissal on the merits of *Barton* claims asserted against chairperson of unsecured creditors' committee.

Cases that cite this headnote

[17] **Bankruptcy**

Creditors' and equity security holders' committees and meetings

Attorney's position as chairperson of unsecured creditors' committee did not entitle him to derivative judicial immunity for all of his actions as chairperson; rather, for derived judicial immunity to apply, attorney must have acted within scope of his authority and candidly disclosed his proposed acts to the bankruptcy court, and Chapter 11 debtor must have had notice of his proposed acts, and bankruptcy court must have approved these acts.

Cases that cite this headnote

Appeal from the United States District Court for the District of Montana, Sam E. Haddon, District Judge,
Presiding, D.C. No. 2:13-cv-00032-SEH

Attorneys and Law Firms

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Before: Alex Kozinski, Richard A. Paez and Marsha S. Berzon, Circuit Judges.

OPINION

KOZINSKI, Circuit Judge:

We consider whether, under *Barton v. Barbour*, 104 U.S. 126, 14 Otto 126, 26 L.Ed. 672 (1881), a plaintiff must obtain a bankruptcy court's permission before suing a member of the Unsecured Creditors' Committee (UCC) in district court, and whether bankruptcy courts have authority to enter a final judgment on *Barton* claims.

BACKGROUND

This is but the latest chapter in the long-running saga of the Yellowstone Mountain Club bankruptcy litigation. *See Blixseth v. Yellowstone Mountain Club, LLC*, 742 F.3d 1215 (9th Cir. 2014) (per curiam); *In re BLX Grp., Inc.*, 419 B.R. 457 (Bankr. D. Mont. 2009). In the late 1990s, Timothy Blixseth and his wife, Edra, developed the Yellowstone Mountain Club, an exclusive ski and golf resort in Montana that caters to the "ultra-wealthy." *Blixseth*, 742 F.3d at 1218; *see also In re BLX Grp.*, 419 B.R. at 460.

***2** As part of his business-development efforts, Blixseth borrowed $375 million from Credit Suisse on behalf of the Yellowstone entities[1] but used some of the proceeds to pay off personal debts. *In re BLX Grp.*, 419 B.R. at 461. Blixseth alleges that he relied on the advice of his attorney, Stephen Brown, who assured him that his actions were lawful.

When shareholders of the Yellowstone entities caught wind of Blixseth's actions, they sued in Montana state court. On Brown's advice, Blixseth settled. Around the same time, Blixseth and Edra divorced. Represented by Brown, Blixseth divided his property pursuant to a marital settlement agreement (MSA) that gave the Yellowstone entities to Edra. *Id.*

In November 2008, Edra filed bankruptcy petitions on behalf of the Yellowstone entities. *Id.* at 462. A month later, the U.S. Trustee appointed nine individuals to serve as the UCC. One of the UCC members—the chairman, no less—was Blixseth's former counsel, Stephen Brown.

Blixseth suspected that Brown used confidential information to Blixseth's detriment in the bankruptcy proceedings. Accordingly, he sued Brown in district court. The district court held that it lacked jurisdiction because Blixseth hadn't first obtained the bankruptcy court's permission to sue, as required by *Barton*.

[1] [2] Under *Barton*, plaintiffs must obtain authorization from the bankruptcy court before "initiat[ing] an action in another forum" against certain officers appointed by the bankruptcy court for actions the officers have taken in their official capacities. *In re Crown Vantage, Inc.*, 421 F.3d 963, 970 (9th Cir. 2005). A district court is considered to be "another forum," requiring leave of the bankruptcy court before a lawsuit can be brought. *In re Kashani*, 190 B.R. 875, 885 (9th Cir. BAP 1995).

The district court recognized that *Barton* normally applies to suits against receivers and bankruptcy trustees but discerned a broader purpose: to "centralize bankruptcy litigation" and "keep a watchful eye" on court-appointed officers. Accordingly, it applied *Barton* to lawsuits against UCC members and dismissed the complaint. In the district court's view, all of Blixseth's claims were "based on Brown's alleged misconduct as Chair of the Unsecured Creditors Committee," and the bankruptcy court never authorized the lawsuit. We previously dismissed Blixseth's appeal from this decision in an unpublished order, determining that it wasn't taken from a "final order."

Blixseth then asked the bankruptcy court for permission to bring his claims in district court. In his *Barton* motion, Blixseth explained that a number of his claims against Brown were based on pre-petition conduct that arose before the bankruptcy litigation began so they didn't relate to Brown's actions on the UCC. The bankruptcy court found it "impossible ... to isolate Blixseth's so-called 'pre-petition malpractice and malfeasance' claims from Brown's activities as a member of the Unsecured Creditors Committee." In a final order, the bankruptcy court denied Blixseth permission to bring his claims in district court and dismissed the claims on the merits. Blixseth appealed to the district court, which affirmed the bankruptcy court. He now appeals to us.

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DISCUSSION

***3 [3] [4]** We review the bankruptcy court's order denying leave to sue for abuse of discretion. *See In re Crown Vantage*, 421 F.3d at 977. And we review de novo whether the bankruptcy court had authority to resolve Blixseth's claims on the merits. *See In re Ray*, 624 F.3d 1124, 1130 (9th Cir. 2010).

I. Applicability of *Barton*

[5] 1. The *Barton* doctrine traditionally applies to actions against receivers and bankruptcy trustees. *See In re Crown Vantage*, 421 F.3d at 970–71 (quoting *Barton*, 104 U.S. at 128); *Leonard v. Vrooman*, 383 F.2d 556, 560 (9th Cir. 1967). The touchstone of the *Barton* inquiry is whether a suit challenges "acts done in [a trustee's] official capacity and within his authority as an officer of the Court." *In re Crown Vantage*, 421 F.3d at 974 (quoting *Leonard*, 383 F.2d at 560); *In re Castillo*, 297 F.3d 940, 945 (9th Cir. 2002) ("[W]ithout leave of the bankruptcy court, no suit may be maintained against a trustee for actions taken in the administration of the estate." (quoting 3 *Collier on Bankruptcy* ¶ 323.03[3] (15th ed. rev. 2001))).

No court of appeals has held that *Barton* applies to suits against UCC members, but some have extended *Barton* to actors who aren't bankruptcy trustees or receivers. The Sixth Circuit held that counsel for the trustee is entitled to *Barton* protection because he is the "functional equivalent of a trustee" for purposes of administering the estate. *In re DeLorean Motor Co.*, 991 F.2d 1236, 1241 (6th Cir. 1993). And the Eleventh Circuit bestowed *Barton* protection on individuals approved to conduct sales of estate property, adopting the "functional equivalent" test announced in *In re DeLorean*. *Carter v. Rodgers*, 220 F.3d 1249, 1251, 1252 n.4 (11th Cir. 2000).

Blixseth argues that the *In re DeLorean* line of cases is inapposite because the defendants in those cases aided the trustee in maximizing the value of the estate. Brown, Blixseth claims, owes no duty to the estate; rather, he represents creditors seeking payment *from* the estate. But Blixseth's view of the UCC's interests is too narrow. The UCC can only maximize recovery for the creditors by increasing the size of the estate. This alignment of interests may explain why the bankruptcy code permits UCCs to initiate the appointment of trustees. *See* 11 U.S.C. § 1103(c)(4); *see also* 7 *Collier on Bankruptcy* § 1103.05[1][e] (16th ed. 2016) (implying that the duties of the committee and trustee overlap because "the role of the committee may be reduced if a chapter 11 trustee is appointed"). Because creditors have interests that are closely aligned with those of a bankruptcy trustee, there's good reason to treat the two the same for purposes of the *Barton* doctrine.

[6] UCC members are statutorily obliged to perform tasks related to the administration of the estate: They "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business." 11 U.S.C. § 1103(c) (2). They "participate in the formulation of a plan." *Id.* § 1103(c)(3). And they examine the debtor. *Id.* § 343; *see also* 3 *Collier on Bankruptcy* § 341.02[5] [d]. A lawsuit challenging any of these actions could seriously interfere with already complicated bankruptcy proceedings. Even the fear that such a lawsuit could be filed—and UCC members would have to answer for their actions in a court unfamiliar with bankruptcy proceedings —may cause UCC members to be timid in discharging their duties. This is doubtless why the Commission to Study the Reform of Chapter 11 recommended extending the *Barton* doctrine to "estate neutrals, and statutory committees and their members." Am. Bankr. Inst., Comm'n to Study the Reform of Chapter 11, *2012–2014 Final Report and Recommendations* 43 (2014), *available at* https://abiworld.app.box.com/s/ vvircv5xv83aavl4dp4h. We conclude that *Barton* applies to UCC members like Brown who are sued for acts performed in their official capacities. *See In re Crown Vantage*, 421 F.3d at 970. Any such suit must be brought in the bankruptcy court, or in another court only with the express permission of the bankruptcy court. *Id.* at 970–71.

***4 [7] 2.** Some of Blixseth's claims allege misconduct by Brown prior to the bankruptcy proceedings. For example, Blixseth alleges that Brown gave dubious legal advice in 2005 about how he could use funds from the Credit Suisse loan, and, as a result, Blixseth became the target of a shareholder lawsuit. Blixseth also alleges that Brown provided subpar representation during the shareholder litigation and divorce by overlooking key defenses and drafting provisions in the MSA that were later deemed unenforceable.

The bankruptcy court held that these claims are "so intertwined with and dependent upon Brown's actions as a member of the Unsecured Creditors Committee" that it is "impossible" to separate the pre-petition claims from

Brown's activities on the UCC. But Blixseth's prepetition claims have nothing to do with Brown's position on the UCC. These claims sound in tort, contract and fraud, and are untethered to Brown's position as Chair of the UCC. And in his *Barton* motion, Blixseth clearly separated his pre-petition claims from the post-petition claims that implicated Brown's activities on the UCC. Accordingly, Blixseth didn't need permission from the bankruptcy court before bringing his pre-petition claims in district court. *See id.* at 974. The courts below erred in concluding otherwise.

[8] **3.** Blixseth's remaining claims challenge conduct related to Brown's actions after he was appointed UCC chair.[2] These claims challenge "acts done ... within [Brown's] authority as an officer of the Court." *Id.* (quoting *Leonard*, 383 F.2d at 560). Blixseth needed the bankruptcy court's permission before bringing these claims in district court.

[9] Bankruptcy courts have applied a five-factor test to decide whether to grant leave to sue in another forum pursuant to *Barton*, or to retain jurisdiction over the claims in bankruptcy court. *See id.* at 976. These factors are: (1) whether the acts complained of "relate to the carrying on of the business connected with the property of the bankruptcy estate," (2) whether the claims concern the actions of the officer while administering the estate, (3) whether the officer is entitled to quasi-judicial or derived judicial immunity, (4) whether the plaintiff seeks a personal judgment against the officer and (5) whether the claims seek relief for breach of fiduciary duty, through either negligent or willful conduct. *In re Kashani*, 190 B.R. at 886–87. Even satisfying "one ... factor[ ] may be a basis for the bankruptcy court to retain jurisdiction." *Id.* at 887.

[10] Blixseth sought a personal judgment against Brown, thereby satisfying the fourth *Kashani* factor.[3] The bankruptcy court didn't abuse its discretion in denying Blixseth's *Barton* motion to bring his post-petition claims in district court.

II. Final Adjudication of Claims Blixseth also claims that the bankruptcy court lacked authority to decide his claims against Brown.

***5 [11] [12] 1.** Brown argues that we need not resolve the question of the bankruptcy court's authority because Blixseth consented to having his claims resolved on the merits and, even if he hadn't consented, the district court's de novo review cured any error. But Blixseth never expressly consented and, at the hearing on the *Barton* motion, he maintained that he had a "right to litigate his legal malpractice claims against Mr. Brown in district court." And the district court's de novo review didn't cure any error resulting from the bankruptcy court entering a final judgment on Blixseth's claims. Though the district court claimed to conduct a de novo review, it didn't undertake a meaningful "claim-by-claim analysis." *Dunmore v. United States*, 358 F.3d 1107, 1114 (9th Cir. 2004). The district court's order didn't afford Blixseth anything close to an independent decision by an Article III adjudicator. *See Wellness Int'l Network, Ltd. v. Sharif*, ––– U.S. ––––, 135 S.Ct. 1932, 1946, 191 L.Ed.2d 911 (2015).

[13] **2.** Blixseth argues that the bankruptcy court exceeded its Article I jurisdiction under *Stern v. Marshall* by adjudicating his claims on the merits. *Stern* prohibits bankruptcy courts from adjudicating "common law cause[s] of action, [that] neither derive[ ] from nor depend[ ] upon any agency regulatory regime." 564 U.S. 462, 494, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). Blixseth points out that his claims sound in tort and contract and thus are "the stuff of the traditional actions at common law" that must be litigated in an Article III forum. *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 90, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (Rehnquist, J., concurring in the judgment).

[14] **[15]** Blixseth reads *Stern* too broadly. *Stern* dealt with claims that didn't "stem[ ] from the bankruptcy itself" and wouldn't "necessarily be resolved in the claims allowance process." 564 U.S. at 499, 131 S.Ct. 2594. *Stern* thus precludes bankruptcy courts from deciding common law claims that have no connection to the bankruptcy estate other than that they happen to be assets of the estate. *Barton* claims are different; they concern actions taken in a trustee's or officer's official capacity. *See In re Crown Vantage*, 421 F.3d at 970.

Because *Barton* claims could not "exist independently of [a] bankruptcy case," *In re Harris*, 590 F.3d 730, 738 (9th Cir. 2009), they are not the "stuff of the traditional actions at common law tried by the courts at Westminster in 1789," *Stern*, 564 U.S. at 484, 131 S.Ct. 2594 (quoting *N. Pipeline*, 458 U.S. at 90, 102 S.Ct. 2858 (Rehnquist, J., concurring in the judgment)). A suit against a bankruptcy court officer for actions undertaken in his official capacity necessarily "stems from the bankruptcy itself." *Id.* at 499, 131 S.Ct. 2594. We conclude that *Stern* doesn't preclude bankruptcy courts from adjudicating *Barton* claims.

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[16] [17] 3. We review de novo the bankruptcy court's dismissal of Blixseth's claims on the merits. *See Barrientos v. Wells Fargo Bank, N.A.*, 633 F.3d 1186, 1188 (9th Cir. 2011). Blixseth raised three post-petition claims that relate to Brown's actions as Chair of the UCC. *See supra* p. —— note 2. The bankruptcy court held that Brown, as an officer of the court, was entitled to derivative judicial immunity for actions taken as Chair of the UCC. But Brown's position on the UCC doesn't entitle him to immunity for *all* actions as Chair. *See In re Castillo*, 297 F.3d at 953. For derived judicial immunity to apply, Brown must have acted within the scope of

Footnotes

his authority and "candidly disclosed [his] proposed acts to the bankruptcy court." *In re Harris*, 590 F.3d at 742 (citations omitted). Additionally, the debtor must have had notice of his proposed acts and the bankruptcy court must have approved these acts. *Id.*

We remand for the bankruptcy court to consider whether Brown is entitled to derived judicial immunity for Blixseth's post-petition claims. Unless he is, we see no reason Blixseth couldn't proceed to discovery on these claims.[4]

* * *

Because *Barton* never applied to Blixseth's pre-petition claims, he can bring them in district court as he originally intended. We remand Blixseth's post-petition claims for further proceedings consistent with this opinion.

AFFIRMED IN PART; VACATED IN PART; REMANDED IN PART.

The parties shall bear their own costs.

All Citations

--- F.3d ----, 2016 WL 6936595

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1 These entities were Yellowstone Mountain Club, LLC, Yellowstone Development, LLC and Big Sky Ridge, LLC. 2 Blixseth alleges that Brown used confidential information that he learned while representing Blixseth. He also claims that Brown drummed up support for a bankruptcy plan that made Blixseth liable to the debtors but exculpated Brown. Finally, Blixseth claims that Brown testified against him in an adversary proceeding, thereby breaching his fiduciary duty.

3 The bankruptcy court also concluded that Brown satisfied the third *Kashani* factor because he was entitled to derived judicial immunity. But if Brown were entitled to judicial immunity, he couldn't be sued in *any* court. We question *Kashani* to the extent it suggests that an officer entitled to judicial immunity may be sued in the bankruptcy court that appointed him. 4 Brown argues that Blixseth's claims are barred by the exculpation clause of the bankruptcy plan. The clause covers any “act or omission in connection with, relating to or arising out of the Chapter 11 cases, [and] the formulation, negotiation, implementation, confirmation or consummation of this Plan.” Blixseth challenged the validity of the exculpation clause in a previous appeal. We held that his challenge wasn't equitably moot and remanded for the district court to consider it in the first instance. *See Blixseth* v. *Yellowstone Mountain Club, LLC*, 609 Fed.Appx. 390 (9th Cir. 2015). On remand, the district court upheld the clause, and Blixseth again appealed. *Blixseth* v. *Yellowstone Mountain Club, LLC*, No. 2:11–cv– 00065–SEH, Dkt. Nos. 163, 164 (D. Mont. Mar. 23, 2016 & Apr. 19, 2016). The validity of the exculpation clause will be decided in that appeal so we express no view of the matter here.

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2016 WL 6875917
Only the Westlaw citation is currently available.
United States Bankruptcy Court, W.D. Oklahoma.

In re: Khrishna Kumar Agrawal, Putative Debtor.

Case No.
16
–
11253
–JDL
|
Signed November 1, 2016

Synopsis
Background: Hearing was held on eligibility of creditors to join in filing an involuntary petition against putative debtor.

[Holding:] The Bankruptcy Court, Janice D. Loyd, J., held that petitioning creditors whose claims were based on final state court judgments which were either unappealed or, if appealed, were not stayed pending appeal, each held claims that were not subject to any "bona fide dispute," of kind that would disqualify creditor from joining in involuntary bankruptcy petition.

So ordered.

West Headnotes (8)

[1] Bankruptcy

Evidence and fact questions

Burden of proof lies on creditors filing an involuntary bankruptcy petition to make prima facie showing of their eligibility to join in petition by demonstrating that their claims are not subject to bona fide dispute, and if such a showing is made, burden then shifts to the alleged debtor to present evidence of bona fide dispute. 11 U.S.C.A. § 303(b)(1). Cases that cite this headnote

[2] Bankruptcy

Evidence and fact questions

Creditors filing an involuntary bankruptcy petition bear burden of showing that alleged debtor is generally not paying its debts as they become due. 11 U.S.C.A. § 303(h)(1).

Cases that cite this headnote

[3] Bankruptcy

Undisputed or contingent claims

Petitioning creditors whose claims were based on final state court judgments which were either unappealed or, if appealed, were not stayed pending appeal, each held claims that were not subject to any "bona fide dispute," of kind that would disqualify creditor from joining in involuntary bankruptcy petition; none of the judgments was by default against judgment debtor who had not participated in proceedings. 11 U.S.C.A. § 303(b)(1).

Cases that cite this headnote

[4] Bankruptcy

Undisputed or contingent claims

To determine whether petitioning creditor's claim is subject to "bona fide dispute," so as to disqualify creditor from joining in involuntary bankruptcy petition, court must decide whether there is objective basis for either a factual or legal dispute as to validity of underlying debt; court need not determine the probable outcome of any such dispute, but merely whether such a dispute exists. 11 U.S.C.A. § 303(b)(1).

Cases that cite this headnote

[5] Bankruptcy

Undisputed or contingent claims

Debtor's subjective intent does not control whether petitioning creditor's claim is considered to be subject to "bona fide dispute," so as to disqualify creditor from joining in involuntary bankruptcy petition. 11 U.S.C.A. § 303(b)(1).

Cases that cite this headnote

[6] Bankruptcy

Undisputed or contingent claims

As general rule, claim which is based on unstayed judgment should not be deemed to be subject to "bona fide dispute" as to either liability or amount, and creditor holding such a claim will thus be eligible to join in involuntary bankruptcy petition, even if judgment is on appeal. 11 U.S.C.A. § 303(b)(1).

Cases that cite this headnote

[7] Bankruptcy

Undisputed or contingent claims

Bankruptcy

Evidence and fact questions

That petitioning creditor's claim is based on unstayed judgment does not give rise to irrebuttable presumption that the claim is not subject to "bona fide dispute," only a presumption, and there may be rare objective circumstances that give rise to "bona fide dispute" as to liability or amount of such a claim, of kind that will disqualify creditor from joining in involuntary bankruptcy petition, such as where judgment was taken when there was no service on debtor, judgment was inadvertently entered against a non-party, judgment was entered by default when debtor was deprived of participation in litigation, or there was patent irregularity on face of proceedings resulting in judgment. 11 U.S.C.A. § 303(b)(1).

Cases that cite this headnote

[8] Bankruptcy

Evidence and fact questions

Bankruptcy court could take judicial notice of state court docket sheet in deciding whether claims based on state court judgments were subject to "bona bide dispute," of a kind disqualifying creditors holding such claims from joining in involuntary bankruptcy petition. 11 U.S.C.A. § 303(b)(1); Fed. R. Evid. 201.

Cases that cite this headnote

Attorneys and Law Firms

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MEMORANDUM OPINION AND ORDER RESOLVING CERTAIN LEGAL STANDING ISSUES IN INVOLUNTARY CASE

Janice D. Loyd, U.S. Bankruptcy Judge

I. Introduction

***1** Before the Court are two discrete, yet multi-faceted legal "standing" questions pertaining to the involuntary bankruptcy petition that was commenced on April 4, **2016**, against the putative debtor, Krishna Kumar Agrawal ("Agrawal"). In other words, before the abovereferenced case is even permitted to go to an evidentiary hearing on the merits of the involuntary petition—to determine whether Agrawal is or is not generally paying his debts as they become due pursuant to 11 U.S.C. § 303(h)(1)[1]—there is a question that must be answered as to whether the involuntary petition was, in fact, commenced by: (a) three or more entities, (b) each of which is the holder of a claim against Agrawal that is not contingent as to liability or the subject of a "bona fide dispute as to liability or amount." 11 U.S.C. § 303(b). There is no issue as to whether the involuntary petition was commenced by three or more creditors, as the involuntary petition was initiated by four Petitioning Creditors. [Doc. 1].

From the pleadings in the case, it appears that all four Petitioning Creditors were involved in state court litigation against Agrawal. Following the Scheduling Conference conducted on July 14, **2016**, the Court, on July 15, **2016**, entered its *Order Setting Evidentiary Hearing* on the Petitioning Creditors' Involuntary Chapter 7 Petition requesting all parties to submit a summary of the state court proceedings giving rise to any judgments entered in favor of the Petitioning Creditors

as well as briefs containing legal authority supporting their respective contentions as to whether a bona fide dispute does or does not exist pursuant to 11 U.S.C. § 303(b)(1) (the "*Order*") [Doc. 40].

In response to the Court's *Order,* Agrawal submitted *Debtor's Overview of What the Proof Will Show and Supporting Authority ("Agrawal's Response")* [Doc. 43], arguing that the Petitioning Creditors' claims are contingent as to liability or the subject of a bona fide dispute as to liability or amount, and that the Petitioning Creditors "cling to certain judgments obtained by fraud, and they unlawfully seek for this Court's protection from state courts' examination to (sic) decisions as to whether or not their conduct was fraudulent." The Petitioning Creditors responded to the Court's *Order* by filing their *Summary of State Court Proceedings Giving Rise to the Claims of the Petitioning Creditors and Legal Authority Regarding Non–Existence of Bona Fide Dispute* ("*Creditor's Response*") [Doc. 44], in which they assert that all four Petitioning Creditors are holders of state court judgments against Agrawal, some of which judgments have not been appealed and others appealed but not stayed on appeal. The *Creditor's Response* concludes that as a result of the judgments, both not appealed or not stayed on appeal, the Petitioning Creditors' claims are not contingent as to liability or the subject of a "bona fide dispute as to liability or amount."

II. Jurisdiction

***2** The Court has jurisdiction over this bankruptcy case pursuant to 28 U.S.C. § 1334(b). Reference to the Court of this contested matter is proper pursuant to 28 U.S.C. § 157(a). The determination of whether an order for relief should be entered in an involuntary bankruptcy case is a core proceeding as contemplated by 28 U.S.C. § 157(b) (2) (A).

III. Burden of Proof

[1] [2] In order to file an involuntary petition in bankruptcy, a creditor must be "a holder of a claim against [the alleged debtor] that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount. § 303(b)(1). The burden of proof lies with the petitioning creditors to establish a prima facie case that their claims are not subject to a bona fide dispute. *Bartmann v. Maverick Tube Corp.*, 853 F.2d 1540, 1543– 44 (10th Cir. 1988). The burden then shifts to the alleged debtor to present evidence of a bona fide dispute. *Id.* In addition, before a bankruptcy court may enter an order for relief in an involuntary proceeding, it must find that "the debtor is generally not paying such debtor's debts as such debts become due unless such debts are the subject of a bona fide dispute as to liability or amount." § 303(h) (1). The petitioning creditors carry the burden of proof to show that a debtor is generally not paying its debts as they become due. *Bartmann*, 853 F.2d at 1546; *In re Harmsen*, 320 B.R. 188, 197 (10th Cir. BAP 2005).

IV. Background—The Claims of the Petitioning Creditors

To say that the litigation and relationship between the Petitioning Creditors and Agrawal has a long, complicated and acrimonious history is an understatement.[2] The litigation between some of the Petitioning Creditors and Agrawal goes back nearly a decade, has consumed thousands of pages of pleadings, and involved numerous state court appeals. The Court need not discuss in detail the history of the litigation; rather, the Court will, as it instructed the parties in its Order, address whether any of the Petitioning Creditors' claims are represented by final judgments or unstayed appeals of those judgments.

1. *The Claim of CO & G Production Group, LLC* (*"CO & G*"). In 2008 litigation was commenced in Tulsa County, Oklahoma, in the case styled "*OnLine Oil Inc., et al. v. CO & G Production Group, LLC, and Jerry Parent*, Case No. CJ–2008–6839". [Doc. 44–3]. *CO & G* brought thirdparty claims against Agrawal and others. On December 5, 2013, the District Court of Tulsa County entered its *Final Journal Entry of Judgment* against Agrawal and others for, in addition to declaratory and injunctive relief, actual damages in the amount of $5,508,689.89, and punitive damages in the same amount. [Doc. 44–4]. The trial court overruled the motions to vacate the judgment filed by Agrawal and the other judgment debtors. Agrawal and the other judgment debtors have appealed the judgment to the Oklahoma Supreme Court (Appellate No. DF–112681), but no appellate bond has been posted or other steps to stay enforcement of the judgment taken, and *CO & G* has attempted to enforce the judgment by way of garnishment and execution.

***3** 2. *The Claim of Spoon Resources, LLC* ("*Spoon*"). In 2008 litigation was commenced in the District Court of Okmulgee County, Oklahoma, in the case styled "*Spoon Resources, LLC, v. Coal Gas Mart, LLC, et. al*, Case No. CJ–2008–01209". [Doc.44–5]. The docket sheet in the *Spoon* case [Doc. 44–5] reflects that a *Journal Entry of Judgment* was entered on April 3, 2009; however, while the Petitioning Creditors represent that the judgment against Agrawal was for actual damages "in excess of $10,000.00" and punitive damages "in excess of $10,000.00", a copy of the *Journal Entry of Judgment* is not included as an exhibit to *Creditor's Response* [Doc. 44], nor is it available for the public on the Oklahoma Supreme Court Network website so that this Court might take judicial notice of same. The motion of Agrawal and the other defendants to vacate the judgment was denied. [Doc. 44–6]. No appeal of the judgment appears to have been taken. In this present bankruptcy case, *Creditor's Response* states that a hearing on the issue of damages to be awarded to *Spoon* above the $20,000.00 awarded in the Judgment of April 3, 2009, has not taken place due to other suits against *Spoon* and others by Agrawal as well as the filing of bankruptcy by Agrawal's affiliate companies in 2009 and 2011. [Doc. 44 ¶ 22].

3. *The Claim of Acadiana Maintenance Services* ("*Acadiana*"). In 2014 *Acadiana* brought litigation against Agrawal and others in the District Court of Beaver County, Oklahoma, in the case styled "*Acadiana Maintenance Services v. Energy Production Services LLC, et al.*, Case No. SC–2014–00037. [Doc. 44–7]. On December 14, 2015, the District Court entered its *Alias Journal Entry of Judgment* against Agrawal and the other defendants in the amount of $3,132.82, with interest at the rate of 5.25% per annum and costs. [Doc. 44–9]. No appeal of the Judgment was taken. [Doc. 44–7].

4. *The Claim of Great American Insurance Company* ("*Great American*"). In 2012 *Great American* brought litigation against Agrawal and others in the District Court of Oklahoma County, in the case styled "*Great American Insurance Company v. General Minerals Corp. et. al.,* Case No.CJ–2012–474". [Doc. 44–10]. On June 21, 2013, the District Court sustained *Great American's* motion for summary judgment and entered its Journal Entry of Judgment against Agrawal and the other defendants, jointly and severally, in the amount of $31,344.92, together with costs in the amount of $363.70. [Doc. 44– 11]. No appeal was taken from the Judgment. [Doc. 44– 10].

V. Legal Analysis—Bona Fide Dispute

[3] As stated in the Introduction above, the Petitioning Creditors' ability to force Agrawal into bankruptcy rests on § 303(b)(1), which provides that involuntary bankruptcy proceedings may be commenced by a petition to the bankruptcy court:

> by three or more entities, each of which is ... a holder of a claim against [the debtor] that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount ... if such non-contingent, undisputed claims aggregate at least $15,325 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims.

[4] **[5]** Because the Bankruptcy Code does not define "bona fide dispute," the courts have developed case law to define the phrase. The seminal case in the Tenth Circuit regarding the meaning of the term "bona fide dispute" is *Bartmann v. Maverick Tube Corp.*, 853 F.2d 1540, 1543–44 (10th Cir. 1988) (quoting *In re Busick*, 831 F.2d 745, 750 (7th Cir. 1987)) wherein the Court adopted the following objective test of what claims are subject to a bona fide dispute as to liability or amount:

> The term "bona fide dispute" is not defined in the Code and has been the subject of much debate. We choose to adopt the standard propounded by the Seventh Circuit as to what constitutes a bona fide dispute: the bankruptcy court must determine whether there is an objective basis for either a factual or a legal dispute as to the validity of debt. The Court need not determine the probable outcome of the dispute, but merely whether one exists. Once the petitioning creditor establishes a prima facie case that its claim is not subject to a bona fide dispute, the burden shifts to the debtor to present evidence of

> a bona fide dispute. Under this objective approach, the debtor's subjective intent does not control whether a claim is considered to be subject to a bona fide dispute. (Citations omitted).

***4** See also, *In re ELRS Loss Mitigation, LLC*, 325 B.R. 604, 625 (Bankr. N.D. Okla. 2005); *In re Miller*, 2012 **WL** 1029534 (N.D. Okla. 2012); *In re Red Rock Rig 101, Ltd.*, 397 B.R. 545 (Table), 2008 **WL** 2052732 (10th Cir. BAP 2008) (unpublished opinion) (holding that "[t]he mere existence of pending litigation is insufficient to establish the existence of a bona fide dispute".).

Employing this "objective standard" to the issue of the existence of a bona fide dispute, the question becomes what is the effect of a petitioning creditor's claim being founded upon a judgment. In other words, does an unstayed judgment (even if it is on appeal) essentially create a presumption of no bona fide dispute? Most courts hold yes. The clear majority view—the "*Drexler*" rule—is that an unstayed, non-default state judgment on appeal is not a "bona fide dispute" for purposes of § 303(b)(1). *In re Drexler*, 56 B.R. 960 (Bankr. S.D.N.Y. 1986); *accord In re AMC Investors, LLC*, 406 B.R. 478, 487 (Bankr. D. Del. 2009); ("The Court holds that the existence of a judgment by a court (other than a default judgment) that has not been stayed is, in and of itself, sufficient to establish that the claim underlying the judgment is not in bona fide dispute for purposes of determining whether a petitioning creditor is eligible to commence an involuntary case. No further inquiry is required."); *In re Marciano*, 708 F.3d 1123, 1126 (9th Cir. 2013); *In re Ransome Group Investors, LLP*, 424 B.R. 547, 551–52 (Bankr. M.D. Fla. 2009); *In re Euro–American Lodging Corp.*, 357 B.R. 700, 712 (Bankr. S.D.N.Y. 2007) (claim of creditor holding unstayed judgment is not contingent or subject to bona fide dispute and pendency of debtor's appeal does not create bona fide dispute because such a holding would radically alter long-standing enforceability of unstayed final judgments).

The Tenth Circuit has not directly addressed the applicability of the *Drexler* rule; however, within the Tenth Circuit in *In re C.W. Mining, Co.*, 2008 **WL** 4279635 (Bankr. D. Utah 2008), *rev'd sub nom* on other grounds, *In re C.W. Mining Co.*, 636 F.3d 1257 (10th Cir. 2011), the court adopted the *Drexler* rule and "the line of case law holding that an unstayed judgment, as to which an appeal is taken by the debtor, is not generally the subject of a bona fide dispute."

[6] [7] As a general rule, this Court finds that an unstayed judgment should not be deemed to be the subject of a "bona fide dispute" as to liability or amount, even if it is on appeal. That is not to say that an irrebuttable presumption always arises, just a presumption. There might be rare objective circumstances that give rise to a bona fide dispute as to liability or amount, such as where a judgment was taken when there was no service on the debtor, a judgment was inadvertently entered against a non-party, a default judgment was taken when the debtor was deprived of participation in the litigation or there was on the face of the proceedings a patent irregularity. See *In re Henry S. Miller Commercial, LLC*, 418 B.R. 912, 921 (Bankr. N.D. Tex. 2009). No such circumstances exist here.

Agrawal's *Response* does not address the legal issue of whether there exists a bona fide dispute as to liability and amount as this Court's *Order* instructed that he do, nor does it mention the legal effect of the judgments entered against him. Rather, Agrawal asserts that his "contentions are well supported on the face of his Motion to Dismiss" and "reurges and adopts by reference the Motion to Dismiss", a Motion which this Court has previously denied. The remainder of his *Response* is a reiteration of allegations which he presumably has asserted in Tulsa County Court litigation with *CO & G* and other nonPetitioning Creditor individuals. Nowhere in his *Response* does he even mention the significance of the judgments held by *Great American* and *Acadiana*. He does note that "Spoon Resources has no judgment." Of course, it does, albeit perhaps interlocutory.[3]

***5** It is incumbent upon Agrawal, as the putative debtor, to come forward with more than the same argument which he made, or intends to make, to the judgment court and with more than a subjective belief that his argument is correct. By his *Response*, Agrawal has simply offered to this Court his belief and argument that the District Courts simply got it wrong. In these circumstances, allowing the bankruptcy court to inquire as to the underlying validity of the Petitioning Creditors' claims, rather than establishing an objective basis for evaluating § 303(b)(1) claims, "turns the court into an odds maker on appellate decision-making." *In re AMC Investors*, 406 B.R. at 485. The "full faith and credit" to which a state court judgment under 28 U.S.C. § 1738 is rendered meaningless if the bankruptcy court could treat an unstayed state court judgment differently than it would

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be treated in its state of origin. If the creditor is entitled to have the judgment treated as valid in the state courts, there is no reason the bankruptcy court should be allowed to question the judgment.

Each of the claims of the four Petitioning Creditors have been reduced to state court judgments. *CO & G's* claims against Agrawal were, to understate the situation, vigorously contested and lengthy. The fact that part of the damages awarded to *CO & G* were based upon Agrawal and other parties "failing to cooperate in the discovery process, abusing the discovery process and violating this Court's orders ... (and) was willful and in bad faith" does not make the judgment vulnerable to challenge as a bona fide dispute. *In re Marciano*, 446 B.R. 407, 428 (Bankr. C.D. Cal. 2010) ("Determining that a claim based on a sanctions judgment is the subject of a bona fide dispute would reward the party whose conduct thwarted the policy of settling disputes on the merits."); *Drexler*, 56 B.R. at 970. The judgment in favor of *CO & G* for over $11 million was appealed but no stay sought. The appeal has been pending since March 2014.[4] The judgment falls within the *Drexler* rule, and is not subject to a bona fide dispute.

[8] *Acadiana's* claim was reduced to judgment by virtue of the *Alias Journal Entry of Judgment* against Agrawal and the other defendants in the amount of $3,132.82, with interest at the rate of 5.25% per annum and costs. [Doc. 44–9]. On its face, the Alias Journal Entry of Judgment may appear to have been taken by default as it states that "[t]he Defendant having been duly summoned and failing to appear." However, the docket sheet reflects that on November 14, 2014, the Defendants filed a "Special Entry of Appearance and Motion to Dismiss." Although the image of that pleading is not available on line, it appears that the case was to some degree defended so that the judgment rendered therein cannot be deemed to be a "default judgment".[5] No appeal of the Judgment was taken. [Doc. 44–7]. The Court finds that no bona fide dispute exists with regard to that claim either as to liability or amount.

***6** The same is true with regard to the claim of *Great American*. Agrawal by counsel entered an appearance in the case. After *Great American* filed a motion for summary judgment, Agrawal filed a pleading entitled *Special Entry of Appearance of Khris K. Agrawal to Quash Service, Answer to Petition and Affidavit in Opposition to Motion for Summary Judgment.* The District Court sustained *Great American's* motion for summary judgment and entered its *Journal Entry of Judgment* against Agrawal and the other defendants, jointly and severally, in the amount of $31,344.92 together with costs in the amount of $363.70. [Doc. 44–11]. The judgment was clearly not a default judgment. No appeal was taken from the Judgment. [Doc. 44–10]. The judgment falls within the *Drexler* rule and is not subject to a bona fide dispute.

Spoon's judgment, although unstayed and unappealed, presents a different issue. It appears that the court granted *Spoon* $20,000.00 in damages and set for hearing the issue of additional damages. Not having resolved all the issues in the case, the judgment therefore appears to be interlocutory in nature and not subject to appeal. The judgment debtors, including Agrawal, filed a motion to vacate the $20,000.00 judgment which was denied. While this Court may view that there is little likelihood of the District Court reversing itself on the $20,000.00 judgment, it should not speculate as to what the District Court might do if the case had gone forward.

There is a split in the decisional law as to whether a petitioning creditor's claim is in dispute as to amount: Is it sufficient if any portion of the debt is in bona fide dispute, or must the undisputed portion of the creditor's claim exceed the $15,325 set forth in § 303(b)(1)? *See e.g.*, *Farmers & Merchants State Bank v. Turner*, 518 B.R. 642, 652 (N.D. Fla. 2014); *In re Demirco Holdings Inc.*, 2006 **WL** 1663237 (Bankr. C.D. Ill. 2006) (bona fide dispute regarding a portion of a creditor's claim does not disqualify creditor: bona fide dispute is relevant only if it has the potential to reduce the total amount of petitioning claims below the statutory threshold); *In re ELRS Loss Mitigation, LLC*, 325 B.R. 604, 626–27 (Bankr. N.D. Okla. 2005) (because $28,000 of petitioning creditor's $83,000 claim was objectively undisputable, creditor held undisputed claim in excess of the statutory minimum and was therefore qualified petitioning creditor). This Court, however, need not address this issue. Because there is no final judgment, only the partial or interlocutory $20,000.00 judgment, and there are three other Petitioning Creditors with final judgments aggregating more than the statutorily required amount, the Court's finding that *Spoon's* claim is still subject to a bona fide dispute does not alter the fact that there are the three sufficient eligible creditors to sustain a finding of an involuntary order for relief.

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IV. Conclusion

If court documents and arguments clearly establish that a claim is or is not subject to a bona fide dispute, a trial is unnecessary to determine whether an involuntary petition is jurisdictional. *In re B.B.S.I., Ltd.*, 81 B.R. 227 (Bankr. E.D.N.Y. 1988); *In re Elsa Designs, Ltd.*, 155 B.R. 859, 863 (Bankr. S.D.N.Y. 1993); *Cf. In re Onyx Telecommunications, Ltd.,* 60 B.R. 492, 496 (Bankr. S.D. New York 1985) (the court is free to determine factual disputes and reach the merits of a subject matter jurisdictional dispute without a formal trial). The Court has determined that three of the four Petitioning Creditors, *CO & G*, *Great American* and *Acadiana* have claims which are not subject to a bona fide dispute as to liability and amount so as to be eligible for filing this involuntary bankruptcy as required by § 303(b)(1).

***7** The Court will hold a trial on **November 2, 2016, at 9:30 a.m.**, for hearing evidence on the contested factual question concerning whether the Putative Debtor, Agrawal, is or is not generally paying his debts as they become due.

The following is ORDERED.

All Citations

--- B.R. ----, 2016 WL 6875917

Footnotes

1 Unless otherwise noted, all statutory references are to sections of the United States Bankruptcy Code, 11 U.S.C. § 101, *et seq.*

2 For example, the docket sheet in the Tulsa County Court litigation involving Petitioning Creditor CO & G Production Group LLC, of which this court may take judicial notice, spans eight years and comprises 232 pages. [Doc. 44–3].

3 In a footnote, Agrawal cites the case of *Stern v. Marshall*, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), although it is not clear for what proposition the case is being cited. In *Stern v. Marshall*, the U.S. Supreme Court held that state based common-law claims may be entitled to jury trial notwithstanding they may be deemed core proceedings. The debtor's right to jury trial on the issue of the validity of an involuntary filing is addressed, in relevant part, by 28 U.S.C. § 1411(b), which provides that "[t]he district court may order the issues arising under section 303 of title 11 to be tried without a jury." *In re Davis*, 23 B.R. 773 (9th Cir. BAP 1982); *In re Wave Energy, Inc.*, 2009 WL 2870476 (Bankr. S.D. Tex. 2009); Resnick and Sommer, *Collier on Bankruptcy*, ¶ 303.20 [4] (17th Ed. 2015).

4 *OnLine Oil, Inc. v. CO & G Production Group LLC, v. Kris Agrawal*, in the Court of Civil Appeals, State of Oklahoma, Case No. 112681 (consolidated with Case No. 112904).

5 The court may take judicial notice of the state court docket sheet. *United States v. Ahidley*, 486 F.3d 1184,1192 n. 5 (10th Cir. 2007) ("We may exercise our discretion to take judicial notice of publicly filed records in our court and certain other courts concerning matters that bear directly upon the disposition of the case at hand."); *Adams v. Watts*, 2009 WL 5101759 (W.D. Okla. 2009) (taking judicial notice of the public records of the District Court of Comanche County available on the Internet); *Shoulders v. Dinwiddie*, 2006 WL 2792671 (W.D. Okla. 2006) (court may take judicial notice of state court records available on the world wide web including docket sheets in district courts); *Stack v. McCotter*, 79 Fed.Appx. 383, 2003 WL 22422416 (10th Cir. 2003) (unpublished opinion) (finding state district court's docket sheet is an official court record subject to judicial notice under Fed.R. Evid. 201).

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This case was not selected for
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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. 10th Cir. Rule
32.1. United States Court of Appeals,
Tenth Circuit.

In re: Larry Ivan Behrends, Debtor.
Virgina Cooley–Linder; Cooley–Linder's
Retail Property, LLC; Virgina C. Linder and Darrell F. Linder, LLC; Cooley Linder's
Frenchquarter, LLC, Plaintiffs–Appellees,
v.
Larry Ivan Behrends, Defendant–Appellant.

No. 15–1420
|
Filed November 14, 2016

(D.C. No. 1:14–CV–03247–REB), (D. Colorado)

Attorneys and Law Firms

Richard Alan Nervig, Law Office of Richard A. Nervig, San Diego, CA, for Plaintiffs–Appellees.

Rachel R. Mentz, Andrew J. Petrie, Ballard Spahr, Denver, CO, for Defendant–Appellant.

Before TYMKOVICH, Chief Judge, BACHARACH and MORITZ, Circuit Judges.

ORDER AND JUDGMENT[*]

Timothy M. Tymkovich, Chief Judge

In this adversary proceeding, Larry Ivan Behrends appeals from the district court's order affirming the bankruptcy court's grant of summary judgment to plaintiffs and denying his cross-motion for summary judgment. Plaintiffs sought a determination that a debt to them, reflected in an arbitration award and confirmed in a Denver District Court judgment, was nondischargeable. Because we agree with the district court that the bankruptcy court properly concluded that the damages awarded against Behrends based on his violations of securities laws were nondischargeable under 11 U.S.C. § 523(a)(19), we affirm.

BACKGROUND

In 2010, plaintiffs filed a Statement of Claim with the Financial Industry Regulatory Authority (FINRA). The Claim named two securities broker-dealers and Behrends as respondents. It alleged they had unlawfully sold plaintiffs "$623,560.53 worth of five highly speculative securities offerings which [they] represented as suitable for retirees like Claimants who were looking for safe income producing investments." Aplt. App. at 47. The Claim charged that the offerings "were non-exempt public securities offerings conducted in violation of state and federal securities laws" which were "the subject of SEC enforcement actions for fraud in the sale of securities." *Id.* It asserted legal claims against all of the respondents, including Behrends, for breach of fiduciary duty, fraud, violation of the Colorado Securities Act, violation of the Texas Securities Act, and negligence. Plaintiffs requested arbitration of these claims.

Behrends filed a pro se answer to the Claim in which he contested plaintiffs' claims and asserted various affirmative defenses. But he did not appear at the scheduled arbitration hearing. On the day of the hearing, at the arbitration panel's request, plaintiffs' counsel placed a telephone call to Behrends, "who indicated he knew about the hearing, but had decided not to show up because he believed there was no point to being there or defending the claim." *Id.* at 83. The broker-dealer respondents also did not appear at the hearing.[1] The arbitration panel found that Behrends knew about the hearing, had been given proper notice and an adequate opportunity to be heard, but chose not to appear.

At the hearing, the arbitration panel "require[d] ... Claimants [to] prove both liability and damages, which they did." *Id.* The panel then issued its written Award, as follows:

1. *The Panel found multiple violations of the Colorado state and federal securities laws (as defined in Section 3(a)(47) of the SEC Act of 1934).*

2. Respondents Capwest Securities and Behrendsare jointly and severally liable for and shall pay to Claimants Virginia Cooley–Linder and Darrell F. Linder

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$285,485.96 in compensatory damages, inclusive of pre-judgment interest.

***2** 3. Respondents Capwest Securities and Behrends are jointly and severally liable for and shall pay to Claimants Virginia Cooley–Linder and Darrell F. Linder post-judgment interest on the amount of $285,485.96 at the Colorado statutory rate....

4. Respondent Behrends is solely liable for and shall payto Claimants Virginia Cooley–Linder and Darrell F. Linder $56,778.08 in additional compensatory damages, inclusive of pre-judgment interest.

5. Respondent Behrends is solely liable for and shall payto Claimants Virginia Cooley–Linder and Darrell F. Linder post-judgment interest on the amount of $56,778.08....

6. Respondent Capwest Securities is solely liable for andshall pay to Claimants Virginia Cooley–Linder and Darrell F. Linder $500,000.00 in punitive damages for egregious violations of state and federal securities laws....

7. Respondents Capwest Securities and Behrends arejointly and severally liable for and shall pay to Claimants Virginia Cooley–Linder and Darrell F. Linder $12,000.00 in attorneys' fees as a sanction for refusal to comply with the production requirements of a duly issued Order of the Panel....

8. Respondents Capwest Securities and Behrendsare jointly and severally liable for and shall pay to Claimants Virginia Cooley–Linder and Darrell F. Linder $375.00 as reimbursement for the nonrefundable portion of the initial claim filing fee previously paid by Claimants to FINRA.

9. Any and all relief not specifically addressed herein isdenied.

10. *The arbitrators have provided an explanation of their decision in this award. The explanation is for the information of the parties only and is not precedential in nature.*

Id. at 83–84 (emphasis added).

Behrends later filed his underlying Chapter 7 bankruptcy case. The bankruptcy court granted plaintiffs relief from the automatic stay, and plaintiffs subsequently filed an action in Denver state district court to confirm the FINRA award. Behrends neither opposed confirmation of the FINRA award nor appealed the district court's judgment confirming the award.

Plaintiffs then filed this adversary proceeding in bankruptcy court, seeking to have the debt declared nondischargeable under § 523(a)(19). Section 523(a)(19) contains two requirements. First, to be nondischargeable, the debt must be for "(i) the violation of any of the Federal securities laws ..., any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or (ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security." 11 U.S.C. § 523(a)(19)(A). Second, the debt must result from,

> (i) any judgment, order, consent order, or decree enteredin any Federal or State judicial or administrative proceeding;
>
> (ii) any settlement agreement entered into by the debtor;or
>
> (iii) any court or administrative order for any damages,fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

Id. § 523(a)(19)(B).

The bankruptcy court found both requirements met. The court also determined that collateral estoppel barred it from reconsidering the merits of the plaintiffs' FINRA claim. Accordingly, it granted plaintiffs' motion for summary judgment and denied Behrends's motion.

***3** Behrends appealed to the district court, which affirmed the bankruptcy court's order.

DISCUSSION

"Whether a debt is dischargeable in bankruptcy under § 523 is a question of law subject to de novo review." *Tripodi v. Welch*, 810 F.3d 761, 766 (10th Cir. 2016). "The burden is on the creditor to show a debt is nondischargeable under § 523(a)." *Okla. Dep't of Sec. ex rel. Faught v. Wilcox*, 691 F.3d 1171, 1174 (10th Cir. 2012) (citing *Grogan v. Garner*,

498 U.S. 279, 283, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991)).

A. Debt Stemming From Violation of Securities Laws—§ 523(a)(19)(A)

Behrends argues that this condition is not met because plaintiffs failed to prove that the arbitration panel actually litigated the issue of whether he violated the securities laws. In his view, plaintiffs must satisfy all of the traditional requisites for application of collateral estoppel, including proving that the issue resolved by the finding was "actually litigated" in the prior proceeding, in order to use the finding of a securities violation contained in a prior judgment such as the arbitration award. In order to give a prior judgment collateral estoppel or issue preclusion effect for purposes of nondischargeability, the prior judgment must generally satisfy state-law preclusion principles. *See* 2 Michael S. Coffman, Lance Miller & Howard J. Steinberg, *Issue Preclusion (Collateral Estoppel)*, 2 Bankr. Litig. § 13:89 (2d ed. July 2007 & Aug. 2016 Update). But the argument fails here because, to satisfy § 523(a)(19), it is not necessary to show that the securities violation was "actually litigated" as understood in state issue preclusion cases. In enacting § 523(a)(19), Congress departed from the common-law understanding of collateral estoppel and issue preclusion principles.

Section 523(a)(19)(B)(i) permits a determination of nondischargeability based on "*any* judgment," (emphasis added). Consistent with this broad language, we have held that a court may give preclusive effect to a default judgment that otherwise satisfies the requirements of § 523(a)(19), *see Tripodi*, 810 F.3d at 766–67.[2] This is true even when state law would otherwise bar the use of collateral estoppel because the plaintiff failed to prove an issue was actually litigated in the prior proceeding. Section 523(a)(19) preempts such state-law requirements. *See, e.g.*, *Paik v. Lee (In re Lee)*, 536 B.R. 848, 859 (Bankr. N.D. Cal. 2015) ("Congress clearly intended to alter the 'actually litigated' requirement of the issue preclusion analysis so that a settlement agreement has a preclusive effect not otherwise available." (brackets and internal quotation marks omitted)); *Voss v. Pujdak (In re Pujdak)*, 462 B.R. 560, 577–78 (Bankr. D.S.C. 2011) ("South Carolina's traditional approach to collateral estoppel, requiring that the matter be 'actually litigated,' is altered in § 523(a)(19) actions ... because collateral estoppel is a common law creature [that] can ... be preempted by Congressional action." (internal quotation marks omitted)).[3] Thus, contrary to Behrends's argument based on plaintiffs' failure to produce transcripts or other evidence of the proceedings to show which issues were "actually litigated" by the arbitration panel, there is no bar to using the arbitration award here.

***4** Behrends also argues that the arbitration panel's findings are insufficient to show a securities law violation because it is not possible to determine from the award such factors as: (1) which securities laws he violated; (2) which acts or omissions were the bases for the alleged violations; (3) which facts support the amount of damages awarded; and (4) what standard of proof the panel applied. In this proceeding, however, all that is required is a determination that the award satisfied the requirements for nondischargeability described in § 523(a)(19). *Cf. Meyer v. Rigdon*, 36 F.3d 1375, 1382 (7th Cir. 1994) (considering, as a legal matter, whether default judgment satisfied requirements for nondischargeability detailed in § 523(a)(11)). An examination of the Claim reveals that those requirements were met.

Behrends's failure to defend means that he admitted all the facts plaintiffs asserted in their Claim. *See Tripodi*, 810 F.3d at 766–67 (stating debt resulting from default judgment stemmed "from a violation of securities laws as set forth—and deemed true—in [the defaulted] complaint"). In their Claim, plaintiffs asserted that Behrends "recommended, solicited, sold and over-concentrated [plaintiffs'] assets in several highly speculative, illiquid private placements" that were not at all suitable for them. Aplt. App. at 49. These private placements "were required to be registered and were sold to [plaintiffs] in violation of Colorado and Texas securities laws governing the sale of unregistered securities." *Id.* The Claim further asserted that the respondents made misrepresentations and omitted material facts in connection with their solicitation and sale of the securities to the plaintiffs. It specifically alleged that these actions and/or omissions violated Colo. Rev. Stat. §§ 11–51–301, 11–51–501(1)(b), and 11–51–501(1)(c). Finally, the panel's award against Behrends was less than the total amount of damages sought against him in the Claim.

To be sure, "even in default, a defendant is not prohibited from challenging the legal sufficiency of the admitted factual allegations." *Tripodi*, 810 F.3d at 765. Here, however,

Behrends does not argue that the admitted facts were insufficient as a matter of law to establish the required securities law violations. Moreover, although plaintiffs included other causes of action in their Claim, the arbitration panel explicitly stated (tracking the language of § 523(a)(19)(A)) that it found numerous violations of federal and Colorado state securities laws. The panel provided no other specific reason for its award.

Finally, Behrends complains that the arbitration panel's award states that it is "for the information of the parties only and ... not precedential in nature." Aplt. App. at 84.[4] We agree with the district court that this language does not preclude the use of the arbitration award's findings and judgment in a proceeding between the parties to determine dischargeability of the debt. To hold otherwise would frustrate the plain meaning of the statute, § 523(a)(19)(B), which does not require a published, precedential decision but permits the use of "*any* judgment," or for that matter, "*any* settlement agreement entered into by the debtor," whether or not incorporated into a precedential decision.

***5** In sum, under these circumstances, we find no basis for reversing the district court's order affirming the bankruptcy court's conclusion that the arbitration panel's award met the requirements of § 523(a)(19)(A).

B. Debt Memorialized in Judicial

Order—§ 523(a)(19)(B) As Behrends concedes, *see* Aplt. Opening Br. at 13, the order of the District Court for Denver County, Colorado confirming the arbitration award and entering judgment thereon qualifies as a judicial order memorializing the debt. It therefore satisfies the requirements of § 523(a)(19) (B).

CONCLUSION

We affirm the district court's order affirming the bankruptcy court's order granting summary judgment to plaintiffs.

All Citations

--- Fed.Appx. ----, 2016 WL 6677596

Footnotes

* After examining the briefs and appellate record, this panel has determined unanimously to honor the parties' request for a decision on the briefs without oral argument. *See* Fed. R. App. P. 34(f); 10th Cir. R. 34.1(G). The case is therefore submitted without oral argument. This order and judgment is not binding precedent, except under the doctrines of law of the case, res judicata, and collateral estoppel. It may be cited, however, for its persuasive value consistent with Fed. R. App. P. 32.1 and 10th Cir. R. 32.1.

1 According to the arbitration award, respondent Capwest Securities notified plaintiffs' counsel it did not intend to show up or defend the case at the hearing. Respondent Workman Securities settled with the plaintiffs.

2 Section 523(a)(19) was adopted as part of the Sarbanes–Oxley Act in 2002, *see Okla. Dep't of Sec.*, 691 F.3d at 1175, and serves the broad remedial purpose of "hold[ing] accountable those who violate securities laws after a government unit or private suit results in a judgment or settlement against the wrongdoer." *Tripodi*, 810 F.3d at 767 (internal quotation marks omitted) (quoting S. Rep. No. 107–146, at *16 (2002)). *See also* Coffman, et al., *Section 523(a)(19): Securities Violations*, 2 Bankr. Litig. § 13:67 ("The policy underlying [§ 523(a)(19)] is to hold parties accountable who violate securities laws and to give collateral estoppel effect to judgments finding the presence of securities fraud.").

3 The district court applied Colorado's law of collateral estoppel, accepting Behrends's argument that "the effects of collateral estoppel on a judgment of a state court must be determined by the law of the forum in which the prior judgment was rendered." Aplt. App. at 13. We previously adopted a three-part test for determining whether collateral estoppel precludes relitigation of factual issues in dischargeability actions under § 523(a), making such findings binding on the bankruptcy court where "(1) the issue to be precluded is the same as that involved in the prior state action, (2) the issue was actually litigated by the parties in the prior action, and (3) the state court's determination of the issue was necessary to the resulting final and valid judgment." *Klemens v. Wallace (In re Wallace)*, 840 F.2d 762, 765 (10th Cir. 1988). Because both the Colorado and *Wallace* tests include the element of actual litigation, and because § 523(a)(19) modifies the requirement in either case, we need not determine whether the Colorado test for collateral estoppel governs this case.

4 Debtor argues that the “FINRA scheme of non-precedential remedies specifically permitted the re-litigation of the issues addressed” under the rule in the Restatement (Second) of Judgments § 84 (1982). Aplt. Opening Br. at 15. He fails to show that he made this argument to the district court. Accordingly, we decline to address it. *See, e.g.*, *PHL Variable Ins. Co. v. Sheldon Hathaway Fam. Ins. Tr. ex rel. Hathaway*, 819 F.3d 1283, 1288 (10th Cir. 2016) (declining to consider argument not made in district court, when proponent did not argue for plain error review).

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