AMERICAN BANKRUPTCY INSTITUTE

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Ronald R. Peterson, Moderator
Jenner & Block; Chicago

Gordon E. Gouveia
Shaw Fishman Glantz & Towbin LLC; Chicago

Timothy F. Nixon
Godfrey & Kahn SC; Green Bay, Wis.

Jeana K. Reinbold
Attorney at Law; Springfield, Ill.

2017

ABI – Jeopardy Case Summaries

1. ***Barton v. Barbour*, 104 U.S. 126 (1881).**

Although originally a case about a receiver, the doctrine that emerged from *Barton* is alive and well in modern bankruptcy courts. Under the *Barton* Doctrine, a bankruptcy trustee cannot be sued for acts within his official capacity without leave from the court that appointed the trustee. However, the trustee's protections under the *Barton* Doctrine do *not* apply to actions the trustee takes in the mere continuation of the debtor's business affairs.

2. ***Phoenician Mediterranean Villa v. Swope (In re J & S Props., LLC)*, 871 F.3d 138 (3d Cir. 2017).**

Swope was appointed chapter 7 trustee for J&S, a real estate company whose largest asset was a building in Altoona, PA. Phoenician—which had a contentious relationship with J&S—had operated a restaurant in that building; it had closed up shop before J&S's petition date, but its lease was still running when J&S filed. To facilitate a sale of the Altoona property, the trustee rejected Phoenician's lease. But when Phoenician attempted to remove its personal property from the building, Swope objected because the bankruptcy court had not yet determined the property's ownership. Swope subsequently learned that Phoenician had cancelled its insurance on the shuttered restaurant. With the infamous 2014 polar vortex fast approaching, Swope requested that Phoenician at least turn the heat in the restaurant high enough to prevent the pipes from freezing. Swope's request went unanswered and the pipes burst, flooding the restaurant. To make matters worse, cries for help to area contractors went unanswered because nobody wanted to get caught in the middle of the feud between Phoenician and J&S. When Swope attempted to enter the property to assess the damage herself, she discovered that the key Phoenician had provided her did not open the interior doors. Swope quickly had J&S change the locks, to which she kept the sole key. Phoenician filed a complaint against Swope, claiming wrongful eviction in violation of the Fourth and Fourteenth Amendments. Swope moved to dismiss, asserting quasi-judicial immunity.

On appeal, the Third Circuit affirmed both the bankruptcy court and the district court on the grounds that Swope was "entitled to qualified immunity because she acted within her statutory duties" as a chapter 7 trustee. The Third Circuit relied on *Harlow v. Fitzgerald*, 457 U.S. 800 (1982), which held that government officials performing discretionary functions are shielded from civil liabilities so long as their conduct does not violate "clearly established" statutory or constitutional rights of which a reasonable person would have known. The circuit court determined that "bankruptcy trustees are government officials, entitled under *Harlow* to qualified immunity from § 1983 claims by third parties when they act in their official capacity in a manner that is not contrary to clearly established law." In the case before it, the court determined that Swope was required to act to perform her statutory duty of preserving estate property in the face of Phoenician's lack of cooperation in preserving the property, the lack of insurance, and the likelihood of future damage from the burst pipes. Accordingly, any claims Phoenician might have against Swope gave way to her exercise of her official duties as trustee.

3. ***In re Al-Haroon B. Husain*, 866 F.3d 832 (7th Cir. 2017).**

A bankruptcy judge disbarred attorney Al-Haroon Husain for routinely filing documents with material misstatements and falsified signatures. On appeal, Husain did not dispute the bankruptcy court's factual findings but argued that his conduct did not warrant disbarment because "everyone does it." The Seventh Circuit did not take kindly to that argument. Not only did the appellate court affirm Husain's disbarment, it also ordered that the previously sealed records in the case be placed in the public record.

4. ***Meoli v. Huntington Nat'l Bank*, 848 F.3d 716 (6th Cir. 2017); *Ivey v. First Citizens Bank & Tr. Co.*, 848 F.3d 205 (4th Cir. 2017); *Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890 (7th Cir. 1988).**

Meoli v. Huntington National Bank, 848 F.3d 716 (6th Cir. 2017), involves a Ponzi scheme and its bank. Prior to bankruptcy, the corporate debtor issued a check that bounced. That fact, raised the suspicious of a bank employee who had noticed unusual activity in the account in the preceding months. The bank decided to raise its concerns with the debtor's principal. The meeting was not the most successfully and several months later the bank decided to begin the process of terminating the relationship fearing the debtor's ability to pay its debt to the bank. During this phase, the bank obtained fairly hard evidence of foul play and discovered that the FBI was investigating the debtor and the principal's previous criminal past. By the time the debtor was exposed and filed bankruptcy, the bank had been paid off.

The trustee brought a fraudulent transfer action against the bank. In opining on the bank's good faith defense, the court held that the bank could not legally assert a good faith defense after the time the bank learned of the principal's criminal past as that was essentially the last piece of information the bank needed to be sure that the debtor was acting fraudulent. For transfers before that magical date, the Sixth Circuit remanded back to the bankruptcy court to reevaluate the bank's good faith defense. The Court held that the proper standard requires "a holistic factual determination of whether a reasonable person, given the available information, would have been alerted to a transfer's voidability." The court went on to note that "What a reasonable person would be alerted to depends not just on whether there was inquiry notice, but also on what investigative avenues existed, whether a reasonable person would have undertaken those avenues given the situation, and what findings the reasonable investigations would have yielded." What that precisely means is anyone's guess.

5. ***Lardas v. Grcic*, 847 F.3d 561 (7th Cir. 2017).**

The court held that a chapter 7 debtor was denied a discharge on "false oath" grounds. The court reasoned that materiality, in the bankruptcy context, has a broad meaning. A fact is material if it 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. The bankruptcy court was not required to find an "affirmative determent" to creditors or an "affirmative benefit" to the debtor in order to conclude that the debtor made a fraudulent statement within the meaning of the Code's false oath provision.

6. ***In re Kempff*, 847 F.3d 444 (7th Cir. 2017).**

Pre-petition, debtor Kempff's soon-to-be-ex-husband was embezzling more than $1 million from his soon-to-be-ex-employer. To avoid detection, he borrowed $400,000 from his friend Farley, telling Farley it was for a real estate deal, but instead using the funds to partially pay back his employer. The ex-husband's scheme caught up with him and he was criminally prosecuted. Meanwhile, his and Kempff's house went into foreclosure and Farley filed a cross-claim in the foreclosure action, seeking to enforce his lien on the house. Kempff filed for bankruptcy protection. Farley filed an adversary to challenge Kempff's eligibility for a chapter 7 discharge. In his complaint, Farley pointed to a handful of misstatements that Kempff made in her schedules—among them, Kempff failed to disclose charges she had made on her parents' credit card as additional financial support, and she recorded a $3,275.35 pre-petition payment to her parents as a $275.35 payment. Kempff testified that the misstatements were innocent mistakes, largely the fault of bad advice from her attorney. The bankruptcy court credited her testimony and denied Farley's contentions, and the district court affirmed.

On appeal, the Seventh Circuit agreed that Kempff lacked the fraudulent intent necessary to deny her a discharge. The circuit court noted that "[e]vidence of 'reckless disregard for the truth is sufficient to prove fraudulent intent'," but that Kempff's statements, taken together, did not rise to the level of reckless disregard for the truth.

***7. Premier Capital, LLC v. Crawford*, 841 F.3d 1 (1st Cir. 2016).**

A creditor sought to deny a debtor's discharge on the grounds that his failure to schedule a separate retirement account constituted a false oath. The bankruptcy court ruled for the creditor. The First Circuit affirmed, holding that the debtor's failure to schedule the account was a "material" false oath.

***8. Slater v. U.S. Steel Corp.*, 2017 WL 4110047 (11th Cir. Sept. 18, 2017).**

In an *en banc* decision, the Eleventh Circuit held that a court must consider all of the facts and circumstances before invoking the doctrine of judicial estoppel. A defendant should not reap an "unjustified windfall" simply because a debtor omits a claim from the bankruptcy schedules. Reversing earlier decisions, the court held that the intentional failure to list a claim will no longer result in the automatic application of judicial estoppel.

***9. Neidenbach v. Amica Mutual Ins. Co.*, 842 F.3d 560 (8th Cir. 2016).**

Approximately one year after filing for chapter 13, the debtors experienced a fire and submitted a claim asserting a loss of $262,500 for personal property damages and $375,000 in damages to their home. The insurance company denied the claim and litigation ensued. During the litigation, it came to light that, in their bankruptcy schedules, the debtors had stated their household goods were worth $7,000. The court issued summary judgment in favor of the insurer. On appeal, the Eighth Circuit affirmed. The court held that the debtors' gross overstatement of value constituted an inaccurate and misleading proof of loss which permitted the insurer to void the entire contract and also precluded coverage for the dwelling.

***10. In re Lua*, 2017 U.S. App. LEXIS 11452 (9th Cir. June 27, 2017).**

In January 2014, a unanimous U.S. Supreme Court decided *Law v. Siegel*, 134 S. Ct. 1188 (2014). The Court held that courts cannot create exceptions to the explicit dictates of Congress. Congress enacted 11 U.S.C. §522(k) to prevent a debtor's exemption from being surcharged to pay costs of administration. No matter how outrageous the debtor's conduct was, Congress, not the courts was the final arbiter. However, the opinion did not stop there. The Court also held that Congress clearly adopted exceptions to the debtor's claim for exemption and the courts were not free to manufacture new ones. This dicta overruled a long line of cases which held that if the debtor acted in bad faith and with prejudice to the creditors and the trustee, she could not amend her exemptions. Under *Law*, if the debtor hid her assets and the trustee found out, she could amend her schedule C and assert an exemption regardless of bad faith or prejudice. Ironically, under the statutory exemptions, if the debtor gave a cooler full of cash to a neighbor for burial in the neighbor's back yard and the trustee avoided the transfer, she could not assert a claim for exemption. However, if she buried the cooler full of cash in her own back yard, she could assert an exemption.

Several courts have ignored this dicta, arguing that it was not part of the Supreme Court's holding. Other courts suggest that Federal Rule of Bankruptcy 403(b)(2) gives the bankruptcy court authority to deny the debtor's request for an amendment. Neither of these approaches has found much favor with either the appellate courts or the commentators.

However, a new line of case has arisen in California. What if the claim for exemption is not valid under state law? Then, the bankruptcy court does not need to create a federal judicial exception to the sly debtor's attempt to assert an exemption on secreted assets.

In *Lua v. Miller (In re Lua)*, 551 B.R. 448 (C.D. Cal. 2015), the debtor filed a voluntary chapter 7 petition. The debtor initially claimed to own 30% of her homestead and asserted the full $75,000 exemption under California law. The debtor subsequently amended her schedules to disclaim any interest in the property and any exemption. In the meantime, the trustee discovered that she did have an interest in the home and entered into an agreement with her non-filing husband to sell the home. The debtor attempted to frustrate the sale. Ultimately, the debtor amended her schedules once again to assert that she owned 50% of the home and was entitled to a $100,000 exemption. Had the debtor succeeded, after the costs of sale there would have been nothing left for creditors.

The trustee objected to the amended exemption on the grounds of judicial estoppel, equitable estoppel and laches. The Bankruptcy Court sustained the trustee's objection. *See In re Lua*, 529 B.R. 766, 779 (Bankr. C.D. Cal 2015). The debtor appealed to the U.S. District Court. The Court noted that the bankruptcy court may deny an exemption if the property were not exempt under state law. *See Law*, 134 S. Ct. at 1196-97. The District Court found that the debtor under California law would be equitably estopped from asserting exemption. The Court found that a trustee who seeks equitable estoppel must satisfy a five part test. First, the trustee must establish that the debtor has misrepresented or concealed a material fact. In the case at bar the debtor lied on her schedules and changed her position constantly. Second, the trustee must show that he had no knowledge of the facts, although ignorance or mistake will not prevent an estoppel when a debtor makes an affirmative statement of facts rather than remains silent. Third, the trustee must also demonstrate that he was ignorant, actually and permissibly, of the truth. Fourth, the court must find that the debtor intended the trustee to act on her representation. Finally, the trustee must demonstrate that he changed his position in reliance on something said or done by the debtor resulting in detriment or prejudice to the party asserting equitable estoppel. The District Court found that equitable estoppel rests firmly upon a foundation of conscience and fair dealing. In the

case at bar, the debtor did not deal fairly with the trustee. She remained silent for three years despite knowing that the trustee was pursuing the property in attempt to compensate creditors, then amended her schedules at the last minute to nullify the trustee's significant efforts and reap a windfall for herself and the marital community.

The debtor again appealed and, in June, the Ninth Circuit decided *In re Lau*, No. 15-56814, 2017 U.S. App. LEXIS 11452 (9th Cir. June 27, 2017). First, the circuit court determined that the only issue the debtor had preserved for appeal was whether the bankruptcy court properly applied equitable estoppel. 2017 U.S. App. LEXIS 11452, at *2. And, according to the Ninth Circuit, the bankruptcy court got it wrong. The court first took issue with the bankruptcy court's reliance on the fact that "Lua's First Amended Schedules were a representation, under oath, that she was not claiming a homestead exemption in the Property." *Id.* at *3. The court reasoned that the first amended schedules could not form the bases of an estoppel because the facts contained therein were readily available to the trustee and, "where the person pleading estoppel had knowledge of the facts, there is no reliance." *Id.* (quoting *Sidebotham v. Robison*, 216 F.2d 816, 829 (9th Cir. 1954)). According to the court, the trustee further "knew, or should have known, that in the event circumstances changed, Lua could amend her exemptions 'as a matter of course at any time before the case [wa]s closed.'" *Id.* (quoting FED. R. BANKR. P. 1009(a)). Next, the Ninth Circuit determined that "the Trustee failed to present any evidence that at the time Lau filed her First Amended Schedules, she had reason to believe she would amend her schedules again at some point in the future," and "nothing in Lau's First Amended Schedules [could] be deemed a representation by Lau that she would not amend her exemptions again if circumstances changed." *Id.* at *4. The court determined that circumstances indeed did change when "the bankruptcy court entered an order finding that the Property was 100% community property, providing Lau a new factual basis to claim a homestead exemption." *Id.* Accordingly, the Ninth Circuit held that there were no grounds for equitable estoppel and reversed.

Judge Callahan dissented, finding that he could not ascribe clear error to the bankruptcy court rising to the level of an abuse of discretion. *Id.* Judge Callahan reasoned that "[b]y amending her initial schedules to remove her claim for a homestead exemption, Lau represented that she would not be seeking such an exemption during her bankruptcy." *Id.* at *4-5. "While it is true that Lau did not know her exact interest in the home at the time she filed her first amended schedules and that Lau never affirmatively stated she would not change her amended exemption election at a later time, Lau stood idly by as the Trustee toiled away, failing to give the Trustee even so much as an indication that she was contemplating claiming the homestead exemption." *Id.* at *5.

The Ninth Circuit did not reject the application of state law equitable remedies to disallow exemptions; it did not address the issue one way or the other. But the limited weight the court gave to the debtor's *sworn* representations in her bankruptcy schedules makes it exceedingly onerous for a trustee to use those representations as the basis for an equitable argument. Especially when the trustee is forced to prove a negative—that the debtor will not amend her schedules when an amendment might prove advantageous.

Elsewhere, an increasing number of courts are grappling with the application of *Law*'s dicta to a variety of unique factual circumstances. The latest turn in *Lua* almost certainly will not be the last. Stay tuned.

***11. Kalesnick v. HSBC Bank USA (In re Kalesnick)*, No. 16-3027 (Bankr. D. Mass. July 11, 2017).**

A chapter 13 debtor sought to avoid an allegedly unperfected mortgage under section 544(a). The lender moved to dismiss for lack of standing. The court agreed with the lender, holding that the debtor lacked standing to pursue avoidance under the strong arm powers. The court determined that section 1303 gives the debtor certain powers of the trustee, but section 544 is not among them. This issue continues to generate litigation across the country with courts coming down on both sides.

***12. Smith v. Capital One Bank (USA) N.A.*, 845 F.3d 256 (7th Cir. 2016).**

Debtor Karen Smith filed for bankruptcy under chapter 13. While her case was pending, Capital One filed suit against the debtor's husband to collect credit card debts that he owed. The debtor brought an adversary proceeding against Capital One, alleging that it had violated the co-debtor stay of section 1301. The bankruptcy court granted summary judgment for the debtor on the theory that Capital One's suit violated the automatic stay due to the interplay between the Bankruptcy Code's stay on co-debtor collections, and Wisconsin marital law, which makes marital property available to satisfy certain debts. The district court reversed, and the debtor appealed.

On appeal, the Seventh Circuit affirmed the district court. The circuit court noted that the co-debtor stay is intended to halt collection efforts on third parties who have co-signed the *debtor's* debts, since such efforts would clearly exert pressure on the debtor as well. But in the case before it, Capital One was not a creditor of the debtor and the credit card debt was not a consumer debt of the debtor. Accordingly, the co-debtor stay did not block Capital One's suit against the debtor's husband.

***13. In re Shank*, 569 B.R. 238 (Bankr. S.D. Tex. 2017).**

Chapter 13 debtors moved for a determination that their deed of trust had been fully paid. The lender never appeared on the motion, nor did it file a proof of claim—although the debtor had filed a claim on the creditor's behalf. The plan, of which the creditor received notice, provided for payment of the claim and the creditor accepted those payments. After completion of the plan, the trustee certified that all plan payments had been made and, for the first time, the creditor asserted that there was still a balance due on its debt. According to the creditor, it still held a lien which could not be voided by the chapter 13 plan because the creditor had not participated in the case. The court rejected the creditor's argument, holding that it had waited too long to object and was bound by the terms of the plan.

***14. In re Tucker*, 2017 WL 27735223 (Bankr. N.D. Iowa June 26, 2017).**

In *Tucker*, the married debtor filed for chapter 13 protection but her husband did not. Subsequently, a creditor obtained a judgment against the debtor's husband for a joint debt and garnished his salary. The debtor moved for contempt, at which point the creditor ceased collection activity. The debtor sought both damages and attorneys' fees. The bankruptcy court held that, while section 1301 does not authorize damages and section 362 was inapplicable, sanctions can

still be awarded under section 105. Accordingly, the court awarded the debtor damages for emotional distress and attorneys' fees.

***15. In re Ortiz-Peredo*, 2017 WL 3050486 (Bankr. W.D. Tex. July 18, 2017).**

A chapter 13 debtor scheduled a worker's compensation recovery as exempt under the wildcard exemption. He subsequently settled his case for $9,000.00. The chapter 13 trustee opposed confirmation of the plan, contending that the debtor failed the best interests test because he was not devoting all projected disposable income to payment of unsecured claims. The court sustained the trustee's objection, reasoning that the settlement's exempt status did not remove it from the calculation of disposable income; since the proceeds were income and therefore disposable income, the debtor was required to include the funds in the calculation of plan payments.

***16. Jahn v. Burke (In re Burke)*, 863 F.3d 521 (6th Cir. 2017).**

Chapter 7 debtors claimed their home as exempt under Tennessee's $7,500 homestead exemption. The trustee believed the debtors' home to be worth significantly more than the amount at which the debtors had scheduled it. Hoping to recoup the undisclosed value, the trustee cut the debtors a check for $7,500 and moved for turnover of the property. The debtors subsequently filed a motion to abandon. The bankruptcy court ruled in favor of the debtors. On appeal, the Sixth Circuit affirmed, noting that there is no authority for the notion that a trustee can tender the exemption amount to the debtor and force them to "skedaddle."

***17. Hawk v. Engelhart*, 864 F.3d 364 (3d Cir.).**

Can money stashed in a shoe box qualify for a state law exemption as a qualifying retirement account under the Bankruptcy Code? The debtors in *Hawk v. Engelhart (In re Hawk)*, 864 F.3d 364 (5th Cir. 2017), argued as much—and the Fifth Circuit thought enough of their argument to publish an opinion on the matter in July.

In *Hawk*, the chapter 7 debtors filed schedules claiming an exemption under Texas state law for approximately $133,000 held in an IRA. 864 F.3d at 366. The trustee convened a meeting of creditors and, thereafter, filed a report declaring no assets to distribute from the debtors' estate. *Id.* The deadline to object to the debtors' claimed exemptions came and went with no objections. *Id.* The next month, though, creditor Rex-TX One filed an adversary proceeding objecting to the debtors' discharge. *Id.* Rex-TX One deposed the debtors and discovered that the debtors had withdrawn all of the funds in their IRA, mostly post-petition, and used the money to pay living and other expenses. *Id.* The debtors indicated that about $30,000 of the withdrawn funds remained "in a shoebox" in the debtors' possession." *Id.* The trustee subsequently demanded that the debtors turn over the withdrawn funds to the estate and, upon their failure to do so, the trustee filed a motion compelling the same. *Id.* at 366-67. The bankruptcy court ordered the debtors to turn over the entire $133,000 withdrawn from their IRA and the district court affirmed. *Id.* at 367.

On appeal, the Fifth Circuit first looked at the Texas law exempting certain retirement funds from a debtor's bankruptcy estate. Texas's exemption law permitted a debtor to exempt funds held in a qualifying retirement account, or funds distributed from a qualifying retirement account *so long as* such funds are rolled over into another qualifying account within 60 days. *Id.* at 367-68 (quoting Texas Property Code § 42.0021).

The debtors argued that the disputed funds were indeed exempt under Texas law at the time of the petition and as of the deadline to object to their claimed objections—and the court should not have looked beyond that point in time to assess the debtors' right to exempt the disputed funds. The debtors cited the "snapshot rule" as support for their argument. *Id.* at 368. Under the snapshot rule, "'the state laws existing when the petition is filed [are] the measure of the right to exemptions," and "the date of filing is the point at which 'the statute and rights of the bankrupt, the creditors and the trustee . . . are fixed." *Id.* (quoting *White v. Stump*, 266 U.S. 310 (1924)).

The Fifth Circuit disagreed. The court reviewed its previous applications of the snapshot rule to demonstrate that it "'is the *entire* state law applicable on the filing date that is determinative,'" and "'[c]ourts cannot apply a juridicial airbrush to excise offending images necessarily pictured in the petition date snapshot.'" *Id.* at 370 (quoting *In re Zibman*, 268 F.3d 298, 304 (5th Cir. 2001)). The Texas exemption law's requirement that funds withdrawn from a retirement account be rolled over into a new account within 60 days was "inextricably intertwined" with the state's overall exemption scheme, such that the exemption law could not be applied in a way that would invalidate the 60 day requirement. *Id.* When the *Hawk* debtors withdrew the funds from their IRA, "the essential character of the property changed from assets held in a retirement account to '[a]mounts distributed from a [retirement] account," and the funds became fair game for the trustee or a creditor to contest their exempt nature. *Id.* at 371. Accordingly, the Fifth Circuit affirmed the bankruptcy court's order denying the debtors' claimed exemption to the withdrawn funds and ordering the funds' turnover. *Id.* at 373-74.

The Fifth Circuit's *Hawk* opinion is to be applauded for putting common sense and equity over rigid adherence to formalistic applications of legal constructs. It should also serve as a reminder to trustees and creditors to keep a watchful eye for a debtor's improper conduct even after deadlines to object have passed.

***18. Sheehan v. Ash*, 2017 WL 2778344, __ B.R. __ (N.D.W.V. June 27, 2017).**

The chapter 7 debtors moved from Louisiana to West Virginia a few months before filing their petition. They owned property in both states as of the petition date. The debtors claimed Louisiana exemptions on personal property located in West Virginia and the trustee objected on the theory that the Louisiana exemptions could not be applied extraterritorially. The bankruptcy court overruled the trustee's objections and the trustee appealed. The district court affirmed, reasoning that the debtors were barred from utilizing West Virginia's exemptions, and so could look to Louisiana's. The court looked to congressional intent, rather than state power, to determine whether exemption schemes could apply extraterritorially and ultimately held that a state's exemptions could apply extraterritorially so long as that state does not prohibit applying exemptions to people or property in other states.

***19. Pinnacle Rest. at Big Sky, LLC v. CH SP Acquisitions*, 2017 U.S. App. LEXIS 23526 (9th Cir. July 13, 2017); *Precision Indus., Inc. v. Qualtech Steel SBQ LLC*, 327 F.3d 537 (2003).**

Lessees beware: section 365(h) of the Bankruptcy Code may read like a security blanket to protect you when your lessor files bankruptcy, but you could be out in the cold if you don't timely seek adequate protection in the face of a pending sale pursuant to section 363(h). On their own, sections 363(f) and 365(h) seem relatively straightforward. Section 363(f) provides that:

> The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—
>
> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
>
> (2) such entity consents;
>
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
>
> (4) such interest is in bona fide dispute; or
>
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C. § 363(f). Section 365(h) provides that:

> If the trustee rejects an unexpired lease of real property under which the debtor is the lessor and—
>
> (i) if the rejection by the trustee amounts to such a breach as would entitle the lessee to treat such lease as terminated by virtue of its terms, applicable nonbankruptcy law, or any agreement made by the lessee, then the lessee under such lease may treat such lease as terminated by the rejection; or
>
> (ii) if the term of such lease has commenced, the lessee may retain its rights under such lease (including rights such as those relating to the amount and timing of payment of rent and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.

11 U.S.C. § 365(h)(1). But, read together, the two provisions seem to be at odds.

At least that had been the district court's conclusion below in *Precision Industries, Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (2003). In *Precision*, Qualitech owned a steel mill in Indiana, and leased a portion of the property to Precision, on which Precision operated a supply warehouse. 327 F.3d at 540. Mired in debt, Qualitech filed for chapter 11 bankruptcy protection and auctioned all of its assets for a credit bid to certain of its pre-petition lenders. *Id.* at 540-41. Qualitech moved for a hearing to approve the sale, and the court entered an order approving the sale of Qualitech's assets "free and clear of all liens, claims, encumbrances, and interests." *Id.* at 541. Precision received notice of the sale hearing, but did not object to entry of the order. *Id.* Thereafter, Qualitech took possession of the warehouse and Precision filed suit, claiming that it

retained a possessory interest in the warehouse under section 365(h). *Id.* The bankruptcy court held that Precision retained no such interest under the terms of the sale order and section 363(f). *Id.* at 541-42. The district court reversed. *Id.* at 542. It reasoned that section 365(h) was "very specific," and as such, should be held to override 363(f) in this case. *Id.*

On appeal, the Seventh Circuit reversed the district court. The circuit court focused on the statutory language, noting that 363(f)'s "any interest" language should not "be understood in a special or narrow sense; on the contrary, the use of the term 'any' counsels in favor of a broad interpretation." *Id.* at 545 (citing *United States v. Gonzalez*, 520 U.S. 1, 5 (1997). Certainly broad enough to capture Precision's leasehold in the warehouse. *Id.* of 546. Accordingly, the court reasoned that Qualitech sold its property free and clear of any interest Precision had in it. *Id.* Turning to the language of section 365(h), the circuit court determined that the provision was designed to protect lessees when a debtor *rejected* a lease—not when a debtor *sold* property subject to a lease, as Qualitech had done. *Id.* at 547. According to the court, a lessees protections in the face of a sale were contained within section 363, which grants courts authority to "prohibit or condition such . . . sale . . . as is necessary to provide adequate protection of [an] interest." *Id.* at 547 (quoting 11 U.S.C. § 363(e)). To protect its interests in the 363 sale, the court found that Precision should have objected to the sale or otherwise sought "adequate protection" before the sale was approved." *Id.* at 548. Because Precision did neither, the court held that Qualitech had sold its property free and clear of Precision's interest and section 365(h) did not change that result. *Id.* In so doing, the Seventh Circuit became the first circuit court to rule on the interplay between sections 363 and 365.

Until now. In July 2017, the Ninth Circuit became the second appellate court to tackle the issue in *Pinnacle Rest. at Big Sky, LLC v. CH SP Acquisitions, LLC (In re Spanish Peaks Holdings II, LLC)*, No. 15-35572, 2017 U.S. App. LEXIS 12526 (9th Cir. July 13, 2017). In *Pinnacle*, the trustee of Spanish Peaks' estate sought leave to auction certain property free and clear of all interests under section 363(f). 2017 U.S. App. LEXIS 12526, at *4. Pinnacle (along with another lessee, Opticom) held a lease on a portion of the property. *Id.* at *3. Unlike the lessee in *Precision*, Pinnacle *did* object to the trustee's motion, arguing that "the [Bankruptcy] Code gave [it] the right to retain possession of the property notwithstanding the sale." *Id.* at *5. The bankruptcy court allowed the auction to proceed, but deferred ruling on Pinnacle's motion until it took up final approval of a sale after the auction. *Id.* at *5. After the auction, the Pinnacle again raised its objection at a hearing to consider final approval of the sale. Again, Pinnacle argued that an order approving the sale of the property free and clear of all interests was inconsistent with Pinnacle's right to remain on the property. *Id.* The bankruptcy court approved the sale free and clear of any interests, "(except any right a lessee may have under 11 U.S.C. § 365(h), with respect to a valid and enforceable lease, all as determined through a motion brought before the Court by proper procedure)." *Id.* at *6. Both parties moved for clarification, and after an evidentiary hearing, the bankruptcy court applied a "case-by-case, fact-intensive, totality of the circumstances, approach" in determining that the trustee had sold the property free and clear of Pinnacle's interests. *Id.* at *7-8. Pinnacle appealed and, at the same time, moved the bankruptcy court for an order awarding monetary compensation as adequate protection for their divested interests in the property. *Id.* at *8 n.3. The district court affirmed, holding that "the sale extinguished the leases because the foreclosure of a mortgage would, under Montana law, terminate any leasehold interests junior to the mortgage," and Pinnacle appealed again. *Id.* at *8.

On appeal, the Ninth Circuit noted that the majority of bankruptcy courts had ruled contrary to the Seventh Circuit's decision in *Precision*. *Id.* at *11; *see also, e.g.*, *In re Churchill Props.*, 197 B.R. 283 (Bankr. N.D. Ill. 1996); *In re Haskell, L.P.*, 321 B.R. 1 (Bankr. D. Mass. 2005); *In re Taylor*, 198 B.R. 142 (Bankr. D.S.C. 1996). Those courts, like the district court in *Precision*, determined that section 365(h)'s more specific language trumped the broad language of section 363(f). *Id.* Nonetheless, the Ninth Circuit rejected the majority view and adopted the Seventh Circuit's reasoning that the two Code provisions do not truly conflict. *Id.* at *13. The court reasoned that "section 363 governs the sale of estate property, while section 365 governs the formal rejection of a lease. Where there is a sale, but no rejection (or a rejection, but no sale), there is no conflict." *Id.* The court further observed that "Pinnacle . . . did not ask for adequate protection until after the sale had taken place—not, indeed, until they had appealed to the district court." *Id.* at *15. The court also noted that section 363(f)(1) authorizes a sale if "applicable nonbankruptcy law" so permits and, "[u]nder Montana law, a foreclosure sale to satisfy a mortgage terminates a subsequent lease on the mortgaged property." *Id.* The court reasoned that the bankruptcy operated like a foreclosure sale and such a sale would have terminated Pinnacle's lease. *Id.* at *15-16.

There are important lessons to be learned from *Precision* and *Pinnacle*. *First*, with two circuits now in accord, lessees should not rely on the "majority" view that section 365(h) will protect their interests in the face of a 363 sale. *Second*, lessees must instead act quickly and precisely when their interests are jeopardized by a pending sale. Although the bankruptcy court and circuit court in *Pinnacle* noted that the lessees there had not moved for adequate protection prior to the sale, the lessees *did* object to the sale on the grounds that it improperly impaired their interests under the Bankruptcy Code. Instead, lessees should be explicit in moving for *adequate protection*, which the *Pinnacle* court defined as "any relief—other than compensation as an administrative expense—that will 'result in the realization by such entity of the indubitable equivalent' of the terminated interest," including "continued possession." *Id.* at *14-15 (citing 11 U.S.C. § 361(3); *Dishi & Sons v. Bay Condos, LLC*, 510 B.R. 696 (S.D.N.Y. 2014)). *Finally*, trustees and debtors should be mindful of deadlines to accept or reject leases. The *Pinnacle* court noted that a trustee's failure to accept or reject a lease could be deemed a rejection, in which case section 365(h) could limit a trustee's ability to subsequently sell free-and-clear property that is subject to the rejected lease. *See id.* at *14.

20. Gray v. Nussbeck (In re Gray), 2017 WL 2484824 (Bankr. D. Kan. June 7, 2017).

A chapter 7 debtor signed a reaffirmation agreement with a creditor after receiving a discharge. Based on that agreement, the creditor subsequently sued the debtor in in state court where the debtor raised the discharge as a defense. The court entered judgment in favor of the creditor. The debtor then went to the bankruptcy court for relief. The bankruptcy court held that the state court judgment in violation of the discharge was void and therefore subject to collateral attack.

21. Isaacs v. DBI ASG Coinvester Fund III, LLC, 569 B.R. 135 (6th Cir. BAP 2017).

Pre-petition, the debtor executed a note and second mortgage in 2003. In March of 2004, the debtor filed a chapter 7 petition. However, the lender did not record its mortgage until June of 2004—when the bankruptcy was still pending. To make matters worse, the lender did not seek relief from the stay to record its mortgage. The debtor received a discharge and the case was

closed. Ten years later, the lender's successor filed a foreclosure action and obtained a judgment. Prior to the foreclosure, the debtor filed a chapter 13 petition and sought to avoid the mortgage lien. The bankruptcy court granted judgment to the debtor, ruling that the state court foreclosure judgment violated the debtor's chapter 7 discharge. On appeal, the court held that the mortgage was valid at the time it was signed and the *Rooker-Feldman* doctrine precluded the bankruptcy court from avoiding the state court foreclosure judgment.

***22. Pollitzer v. Gebhardt*, 860 F.3d 1334 (11th Cir. 2017).**

Debtor Pollitzer filed for bankruptcy under chapter 13 and submitted his repayment plan. After making payments on the plan for two years, Pollitzer converted his case to chapter 7 under section 1307 of the Code. The U.S. Trustee moved to dismiss Pollitzer's case as abusive under section 707(b), because Pollitzer's disposable income far exceeded the means-test for chapter 7 cases. Pollitzer countered that under the plain text of section 707(b), the means test did not apply to cases *converted* to chapter 7 as opposed to cases *filed* under chapter 7. Both the bankruptcy and district courts rejected Pollizer's textual argument.

On appeal, the Eleventh Circuit affirmed. It held that Pollitzer's proposed reading of section 707 was "inconceivable," and the section would be "eviscerated" if his approach were adopted.

***23. Carroll v. Takada*, 864 F.3d 512 (7th Cir. 2017).**

Debtors John and Catherine Carroll claimed a $30,000 exemption for Catherine's interest in a spendthrift trust, settled by her deceased parents. The trustee objected and the bankruptcy and district courts sustained the objection. On appeal, the Seventh Circuit affirmed. According to the circuit court, the state statute that prevented creditors from reaching property in a spendthrift trust does not apply when the trust property is distributed to the beneficiary. The trust interest had vested in the debtor prior to the petition date and so was not excluded from property of the estate.