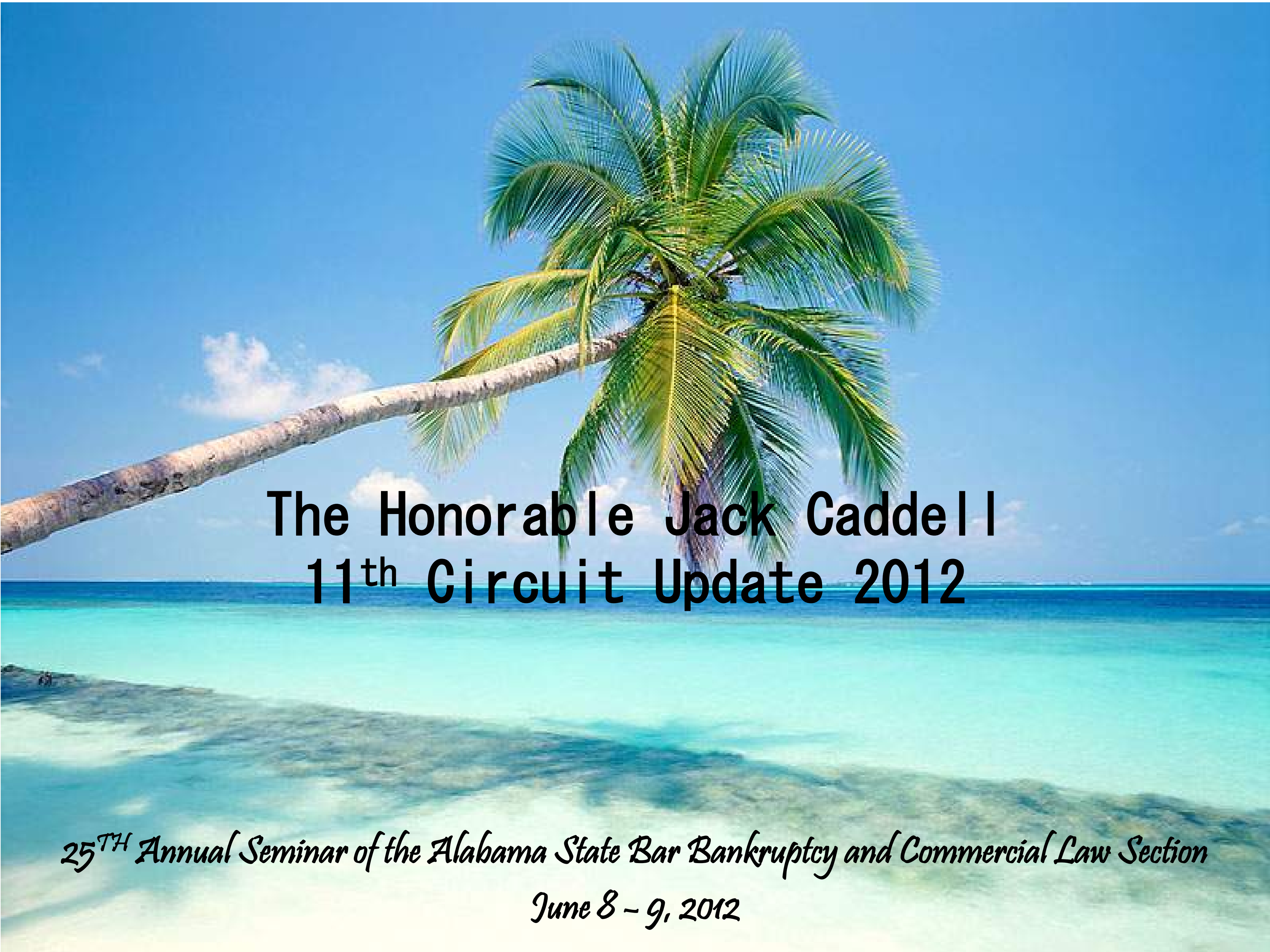
The Honorable Jack Caddell
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BANKRUPTCY DECISIONS OF THE ELEVENTH CIRCUIT COURT OF APPEALS AND SUPREME COURT OF THE UNITED STATES FOR THE PAST YEAR

JACK CADDELL
UNITED STATES BANKRUPTCY JUDGE
NORTHERN DISTRICT OF ALABAMA

June 2012

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28 U.S.C. § 157. Procedures

1. Stern v. Marshall, 131 S. Ct. 2594 (2011)(Roberts, C.J., Scalia, Kennedy, Thomas, and Alito, JJ.)(Breyer, Ginsburg, Sotomayor, and Kagan, JJ., dissenting): In a five-four decision split along ideological lines, the Supreme Court has ruled that a bankruptcy court lacked authority under Article III to resolve a state law counterclaim. Writing for the majority, Chief Justice Roberts opened the opinion, writing:

> This "suit has, in course of time, become so complicated, that ... no two ... lawyers can talk about it for five minutes, without coming to a total disagreement as to all the premises. Innumerable children have been born into the cause: innumerable young people have married into it;" and, sadly, the original parties "have died out of it." A "long procession of [judges] has come in and gone out" during that time, and still the suit "drags its weary length before the Court."[1]

BACKGROUND:

- At the age of 26, Anna Nicole Smith (Vickie Lynn Marshall)(hereinafter "Vickie") married J. Howard Marshall, II when he was 89. Approximately 14 months later J. Howard died in 1995 leaving nothing in his will to Vickie.
- After J. Howard passed away, Vickie sued his son, Pierce, in Texas probate court alleging that Pierce fraudulently induced J. Howard to sign a living trust that did not include her even though J. Howard meant to give her half his property.
- Pierce responded by filing a separate state court defamation lawsuit in Texas against Vickie.
- In 1996, Vickie filed for bankruptcy in California. Pierce filed a proof of claim in the case for defamation damages and a nondischargeability complaint. Vickie responded by filing a counterclaim in the AP asserting tortious interference with the gift she expected from J. Howard.
- In 2000, the bankruptcy court issued a judgment on Vickie's counterclaim and awarded her $475 million. The bankruptcy court found that Vickie's counterclaim was a "core proceeding" under § 157(b)(2)(C) and the court therefore had the power to enter judgment on the counterclaim under § 157(b)(1).
- Pierce appealed the bankruptcy judgment and while the appeal was pending, the Texas probate court entered judgment finding that Pierce was entitled to J. Marshall's estate free of Vickie's claim.
- Subsequently, on appeal the district court overruled the bankruptcy court's entry of final judgment finding that although the counterclaim fell within the literal language of § 157(b)(2)(C) as a "core proceeding," Supreme Court precedent suggested that it would be

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[1] *Stern v. Marshall,* 131 S.Ct. 2594, 2600 (U.S. 2011)(explaining that these words quoted from Charles Dicken's Bleak House aptly describe the turn of events in this case).

unconstitutional to hold that any and all counterclaims are core. The district court instead treated the bankruptcy judgment as a proposed judgment. Although the Texas probate court had already conducted a jury trial and entered judgment in favor of Pierce, the district court declined to give the state court judgment preclusive effect and engaged in its own independent review of the bankruptcy record. Like the bankruptcy court, the district court found that Pierce had tortiously interfered with Vickie's gift expectancy and awarded Vickie $88 million.

- In December of 2004, the Ninth Circuit reversed the district court's award on the grounds that the probate exception to federal subject matter jurisdiction precluded the district court's consideration of the case. The Supreme Court reversed finding that the Ninth Circuit construed the probate exception too broadly and remanded for consideration of the merits of the case, including whether the Vickie's claim was core and whether the Pierce's preclusion arguments had merit.
- In March of 2010, the Ninth Circuit ruled that Vickie's counterclaim was a "noncore proceeding" over which the bankruptcy court could only submit proposed findings of fact and conclusions of law to the district court. Because the state court entered final judgment before the district court entered its decision, the state court ruling had preclusive effect.

On appeal to the Supreme Court for the second time, the majority held that while § 157(b)(2)(C) allowed the bankruptcy court to enter final judgment on Vickie's counterclaim (i.e. statutory authority), Article III of the Constitution did not. The bankruptcy court lacked the constitutional authority to enter a final judgment on a state law counterclaim that was not resolved in the process of ruling on a creditor's proof of claim.

STATUTORY AUTHORITY:

- District courts have "original and exclusive jurisdiction of all cases under title 11." 28 U.S.C. § 1334(a).
- There are three categories of bankruptcy proceedings:
  - those that "arise under title 11," i.e. those that arise under the Bankruptcy Code; e.g. preference action
  - those that "aris[e] in" a Title 11 case, i.e. those that arise in a bankruptcy case; e.g. claims objections
  - those that are "related to a case under title ll."
- District courts may refer such proceedings to bankruptcy courts or withdraw the reference for cause shown. 28 U.S.C. § 157(a) and (d).
- Bankruptcy judges may enter final orders on all "core proceedings." Section 157(b)(2) provides that "core proceedings" include, but are not limited to, sixteen different types of matters, including counterclaims by a debtor against a person filing a claim against the estate.

- If a bankruptcy judge determines that a proceeding is not a core proceeding but is otherwise "related to" the bankruptcy case, the judge may only submit proposed findings of fact and conclusions of law to the district court which will then enter final judgment after a *de novo* review.
- Pierce argued that the bankruptcy court could only enter final judgment on a "core proceeding" if the proceeding also arose in the bankruptcy case or under the Bankruptcy Code, but the Supreme Court explained that all core proceedings necessarily either arise in a bankruptcy case or under the Bankruptcy Code. Specifically in this instance, §157(b)(2)(C) permitted the bankruptcy court to enter final judgment on Vickie's tortious interference counterclaim.
- As another alternative to reach the constitutional issue, Pierce argued that the bankruptcy court lacked statutory jurisdiction to enter final judgment on his defamation claim. Section 157(b)(5) provides that "[t]he district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending . . ." Pierce argued that his defamation claim was a "personal injury tort" and that the bankruptcy court therefore had no jurisdiction over that claim and that the court, therefore, also lacked jurisdiction over Vickie's counterclaim as well. Section 157(b)(5) does not address subject matter jurisdiction, but instead simply specifies the venue in which a personal injury tort or wrongful death claim should be tried. While subject matter jurisdiction cannot be waived, venue can. Here Pierce waived venue by failing to object "until over two years — and several adverse discovery rulings." Although the Supreme Court rejected Pierce's **statutory** arguments and found that § 157 allowed the bankruptcy court to enter final judgment on Vickie's counterclaim, the Supreme Court nevertheless determined that the bankruptcy court lacked **constitutional jurisdiction** to enter same.

Title 28, § 157 reads in full:

> **(a)** Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.
>
> **(b)(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.**
>
> **(2) Core proceedings include, but are not limited to--**
>
> **(A)** matters concerning the administration of the estate;
>
> **(B)** allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;
>
> **(C) counterclaims by the estate against persons filing claims against the estate;**

(D) orders in respect to obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid, or recover preferences;

(G) motions to terminate, annul, or modify the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges;

(K) determinations of the validity, extent, or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

(4) Non-core proceedings under section 157(b)(2)(B) of title 28, United States Code, shall not be subject to the mandatory abstention provisions of section 1334(c)(2).

(5) The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.

(c)(1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

(2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.

(d) The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

(e) If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties.

CONSTITUTIONAL ISSUE:

- Article III, § 1 of the Constitution reads in full:

  > **Section 1.** The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, **shall hold their Offices during good Behavior, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.**

- The Supreme Court previously faced an Article III challenge to a bankruptcy court's jurisdiction in ***Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.***, 458 U.S. 50 (1982). In *Northern Pipeline*, the Supreme Court held unconstitutional the broad grant of jurisdiction given bankruptcy judges under the Bankruptcy Reform Act of 1978. In that case, the debtor filed a suit against Marathon seeking damages for a state law contract claim. Marathon sought dismissal on the ground that the 1978 Act unconstitutionally conferred Article III judicial power on judges who lacked life tenure and protection against salary diminution. The Supreme Court explained that the judicial power of the United States must be exercised by judges who have the attributes of life tenure and protection against salary diminution. These attributes were given to Article III judges to ensure the independence of the Judiciary from the control of the Executive and Legislative branches.
- In 1984, Congress responded to *Northern Pipeline* by amending the statutes governing bankruptcy jurisdiction. The 1984 Act permitted the newly constituted courts to enter final judgments only in core proceedings listed in § 157(b)(2). The Supreme Court explained that "[w]ith respect to such "core" matters, however, the bankruptcy courts under the 1984 Act exercise the same powers they wielded under the" 1978 Act. *Stern v. Marshall*, 131 S. Ct. 2610. For example, as in *Northern Pipeline*, bankruptcy courts are now charged under § 157(b)(2)(C) with resolving "[a]ll matters of fact and law in whatever domains of the law to which" a counterclaim may lead. *Id.* As in *Northern Pipeline* the bankruptcy courts enter final judgments which are binding and final unless appealed. Thus, nothing was changed.
- Vickie argued that the bankruptcy court's entry of final judgment on her state law counterclaim was constitutional despite the similarities between the power wielded by bankruptcy courts under the 1978 Act and those exercising core jurisdiction under the 1984 Act. The Supreme Court disagreed finding the bankruptcy court clearly exercised the "judicial power of the United States" by entering final judgment on a state common law claim just as the bankruptcy court in *Northern Pipeline.* The fact that the defendant in *Northern Pipeline* was not a creditor in the case whereas Pierce filed a proof of claim in Vickie's case was irrelevant. Vickie's claim was a "state law action independent of the federal bankruptcy law and not necessarily resolvable by

a ruling on the creditor's proof of claim in bankruptcy." *Id*. at 2611.

- Vickie's counterclaim did not fall under the "public rights" exception. Under the "public rights" exception, matters involving public rights may be removed from Article III courts and delegated to non-Article III courts. While the Government does not have to be a party to the action for the exception to apply, the claim at issue must be derived from a federal regulatory scheme or must somehow be integrally related to a particular federal government action. In ***Granfinanciera, S.A. v. Nordberg***, 492 U.S. 33 (1989), the Supreme Court rejected a bankruptcy trustee's argument that a § 548 fraudulent conveyance action filed against a noncreditor fell within the "public rights" exception. The issue before the Supreme Court was whether the Seventh Amendment conferred on the noncreditor defendant a right to a jury trial. Unless a legal cause of action involves a "public right," Congress may not deprive parties litigating over such a right of the Seventh Amendment's guarantee to a jury trial. Under the "public rights" exception, "[i]f a statutory right is not closely intertwined with a federal regulatory program Congress has power to enact, and if that right neither belongs to nor exists against the Federal Government, then it must be adjudicated by an Article III court." *Id.* at 2614. Because fraudulent conveyance suits resemble "state law contract claims brought by a bankrupt corporation to augment the bankruptcy estate," the Supreme Court concluded that such claims were more accurately characterized as a private right rather than a public right and, thus, the defendant had a right to a jury trial. *Id. Granfinanciera* gave the right to a jury trial under § 548.
- The Supreme Court applied the same "public rights" analysis in *Stern* and concluded that Vickie's counterclaim, like the fraudulent conveyance claim in *Granfinanciera,* did not fall within the public rights exception and was, instead, one under state common law between two private parties. Vickie's counterclaim did not depend on the will of Congress. This case involved the "most prototypical exercise of judicial power: the entry of a final, binding judgment *by a court* with broad substantive jurisdiction, on a common law cause of action, when the action neither derives from nor depends upon any agency regulatory regime." *Id.* at 2598.
- Pierce's decision to file a proof of claim did not alter the characterization of Vickie's counterclaim. "[P]roperty interests are created and defined by state law,' and '[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.* at 2616. Pierce's proof of claim for defamation damages in no way affected the nature of Vickie's counterclaim as one at common law that simply attempted to augment the bankruptcy estate like the fraudulent conveyance claim in *Granfinanciera*.
- The Supreme Court distinguished *Stern* from ***Katchen v. Landy***, 382 U.S. 323 (1966) in which the Supreme Court held that the bankruptcy court had

jurisdiction to adjudicate a voidable preference claim brought against a creditor who had filed a proof of claim because it was not possible for the court "to rule on the creditor's proof of claim without first resolving the voidable preference issue." In ruling on Vickie's counterclaim, the bankruptcy court made several factual and legal determinations that were not disposed of in passing on objections to Pierce's proof of claim for defamation which the court had denied almost a year earlier. The counterclaim for tortious interference raised issues of law entirely different from those raised on the defamation claim. Moreover, the trustee's action in *Katchen* and another case, *Langenkamp v. Culp*, 498 U.S. 42 (1990), asserted a right under the Bankruptcy Code, § 547(b), to recover an avoidable preference. Vickie's claim in contrast was in no way derived from or dependent upon bankruptcy law. It was a state tort action that existed without regard to any bankruptcy proceeding.

- The Supreme Court rejected Vickie's argument that the bankruptcy court's final judgment was constitutional because bankruptcy courts are deemed "adjuncts" of the district courts under the 1984 Act. A bankruptcy court resolving a counterclaim under § 157(b)(2)(C) has the power to enter final judgment subject to review only if a party chooses to appeal. Given that authority, a bankruptcy court can no more be deemed a mere "adjunct" of the district court than a district court can be deemed an adjunct of the court of appeals.

ANALYSIS: Below are some thoughts expressed by Dean Erwin Chemerinsky, University of California, Irvine School of Law, a nationally recognized Constitutional law expert on this decision:

- **Why was this decision divided along ideological lines?** The underlying premise of this decision is that only Article III judges can decide state law claims. The majority discusses in depth the importance of the separation of powers and how Article III plays a key role in that regard. It is interesting that what is troubling to the majority is that a non-Article III judge decided a state law matter. State court judges are not Article III judges, so why is it so objectionable for a non-Article III bankruptcy judge to decide a state law counterclaim? This concern traces back to the Supreme Court's decision in ***Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.***, 458 U.S. 50 (1982)(discussed above). In 1980, Ronald Reagan was elected president and the Republicans gained control of the Senate for the first time since 1953. In 1981, there was a flood of bills introduced to strip the federal courts of jurisdiction to decide matters like abortion, busing, and school prayer. There was a great debate at the time over whether Congress had authority to strip federal courts of such jurisdiction. *Northern Pipeline* was decided in the midst of this controversy as a message to Congress that limits on Article III jurisdiction would be carefully scrutinized by the Supreme Court. Now the current Supreme Court has carried *Northern Pipeline* forward in *Stern v.*

Marshall with the conservative majority.

- **What is *Stern v. Marshall* likely to mean?** Chief Justice Roberts presents the holding of this case as being vary narrow, writing:

Article III of the Constitution provides that the judicial power of the United States may be vested only in courts whose judges enjoy the protections set forth in that Article. We conclude today that Congress, in one isolated respect, exceeded that limitation in the Bankruptcy Act of 1984. **The Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim.**

Id. at 2620. It is unlikely that *Stern* will actually be interpreted this narrowly. In defining the jurisdiction of the bankruptcy courts, Chief Justice Roberts also wrote, **"the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process."** *Id.* at 2618. This is a very narrow definition of bankruptcy court jurisdiction and matters over which the bankruptcy courts may issue final judgment. The district court still has subject matter jurisdiction and the bankruptcy court can still submit proposed findings of fact and recommendations of law to the district court over matters that exceed the bankruptcy court's narrowly defined jurisdiction.

- **Can consent of the parties resolve the issue?** Bankruptcy Rule 7008(a) provides that a "complaint . . . shall contain a statement that the proceeding is core or non-core and, if non-core, that the pleader does or does not consent to entry of final order or judgment by the bankruptcy judge." Rule 7012(b) provides that "[a] responsive pleading shall admit or deny an allegation that the proceeding is core or non-core. If the response is that the proceeding is non-core, it shall include a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy judge. In non-core proceedings final orders and judgments shall not be entered on the bankruptcy judge's order except with the express consent of the parties." Unfortunately it does not seem, however, that consent will cure the Constitutional concerns raised by Chief Justice Roberts under Article III. Article III defines the subject matter jurisdiction of the federal courts. The majority found that as a matter of Article III bankruptcy courts cannot issue final judgments with regard to state law counterclaims. Consent cannot cure subject matter jurisdiction. Certainly the filing of a proof of claim can no longer be taken as consent, but it also appears that the jurisdictional issue cannot be cured with express consent.
    - In **AT&T Mobility LLC v. Concepcion,** 131 S.Ct. 1740 (2011), the Supreme Court held that the plaintiff was bound by the terms of an agreement with AT&T that required the plaintiff to submit any disputes with AT&T to arbitration and prohibited class action arbitration. Plaintiffs filed a class

action against AT&T for fraud after AT&T charged same $30 for a phone that AT&T had advertised as free. AT&T moved to compel arbitration on an individual basis under the Federal Arbitration Act which provides that contracts in interstate commerce with arbitration agreements shall be enforced unless the arbitration clauses are revocable under state law. The Ninth Circuit determined that the arbitration clause was not enforceable under the Federal Arbitration Act because the clause was revocable under California state law. The California Supreme Court previously held that arbitration clauses which preclude participation in class actions are unenforceable because they violate public policy. The Supreme Court reversed finding as a matter of policy that the plaintiff's unknowing waiver of the right to trial was nevertheless enforceable. Given the Supreme Court's ruling in *Concepcion*, what basis would there be for the Supreme Court to find that parties cannot knowingly consent to bankruptcy jurisdiction with regard to a state law claims? The Supreme Court could potentially find that parties are free to agree by contract that someone other than the federal judiciary may decide a dispute between the parties, i.e. agree to arbitration. When, however, the matter is before the judiciary, the authority of the federal judiciary is determined by Article III and Congress cannot take jurisdiction from the Article III courts by consent of the parties.

- **Other procedural implications of *Stern*:**
  - Must the issue be raised *sua sponte* by the judge? Yes.
  - May the bankruptcy court accept a settlement in a case involving a state law claim? Again, consent may not cure, however, after appeal time runs the order becomes final.
  - May the bankruptcy court enter default judgment? Same as a final judgment, i.e. not subject matter jurisdiction.
  - What about BAP jurisdiction? What if this case had been appealed not to the district court, but to the BAP? What does *Stern* mean with regard to the ability of BAP judges to be involved in state law matters? This may be the end of BAP's.
  - Magistrate judges conduct jury trials by consent of the parties. If the Supreme Court determines that consent is not sufficient, then the magistrate judges will also no longer be able to conduct jury trials.
  - What would happen in a case where one party consents to

jurisdiction and then loses? Even someone who consents and then loses can still challenge subject matter jurisdiction.

- What about cases that have already been decided? Traditionally final judgments cannot be set aside as void, but cases that remain on appeal are subject to dismissal because subject matter jurisdiction can be raised at anytime before an order becomes final.
- If there is concern that the bankruptcy court lacks jurisdiction, may the court enter final judgment but include therein that if it is later determined that the court lacks jurisdiction that the judgment should be treated as a report and recommendation with proposed findings of facts and conclusions of law?
- What about non-core matters? Can the bankruptcy courts determine such matters if the parties cannot consent to jurisdiction?

CONCURRING AND DISSENTING OPINIONS:

- Justice Scalia wrote a concurring opinion in which he raised the question of whether or not there can be bankruptcy courts at all without Article III judges. Justice Scalia wrote that he did not have to decide this issue now and left it as an open question.
- Justice Breyer wrote the opinion for the dissent in which he takes a practical approach by recognizing the volume of work produced by bankruptcy courts. Justice Breyer points out that there were 1.6 million bankruptcy petitions filed in 2010 and compared this to the 280,000 civil filings in federal courts and the 78,000 criminal cases. He focuses on the practical effect of the majority opinion.

CONCLUSION: Bankruptcy courts must make findings of facts and conclusions of law (recommendations) to district courts on non-core and state law causes of action.

A recent scholarly article was written by George W. Kuney, a Lindsey Young Distinguished Professor of Law and the Director of the James L. Clayton Center for Entrepreneurial Law at The University of Tennessee College of Law, appearing in 21 NORTON J. BANKR. LAW & PRAC. 1 Art. 1 (2012). The following are some of the key observations made by Professor Kuney:

- The Constitution does not itself grant Article III judges jurisdiction. Rather, that is left to Congress to do as it did in the Judiciary Act of 1979 and subsequently in 28 U.S.C. § 1334. In legislation granting jurisdiction, Congress is limited by the

Constitution in the same way that a board of directors is limited by a corporate charter. Thus, to protect the judicial system from undue political influence, Professor Kuney notes that in *Stern* Justice Roberts explained:[2]

> Article III protects liberty not only through its role in implementing the separation of power, but also by specifying the defining characteristics of Article III judges.
>
> ...
>
> Article III could neither serve its purpose in the system of checks and balances nor preserve the integrity of judicial decision making if the other branches of the Federal Government could confer the Government's "judicial Power" on entities outside Article III. That is why we have long recognized that, in general, Congress may not "withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at common law, or in equity, or in admiralty.. . . When a suit is made of "the stuff of the traditional actions at common law tried by the courts at Westminster in 1789" . . . , and is brought within the bounds of federal jurisdiction, the responsibility of deciding that suit rests with Article III judges in Article III courts.

Thus, according to Professor Kuney, when Congress enacted 28 U.S.C. § 1334 granting district courts original and exclusive jurisdiction over "all cases under title 11" and granting same original but not exclusive jurisdiction over "all civil proceedings arising under title 11, or arising in or related to cases under title 11," and 28 U.S.C. § 157(a) allowing the district court to refer "all proceedings arising under title 11 or arising in or related to a case under title 11" to bankruptcy judges, it could not constitutionally confer the district courts with the power to enable the bankruptcy judges to enter final judgments in actions that would constitute "the stuff of the traditional actions at common law tried by the courts at Westminster in 1789."

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[2] Congress has authority to establish courts pursuant to the following provisions in the Constitution:

> Art. 1, § 8: The Congress shall have Power . . . To constitute Tribunals inferior to the supreme Court.
>
> Art. III, § 1: The judicial Power of the United States shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.

- There is no statutory authority for bankruptcy courts to take dispositive action with regard to disputes statutorily defined as "core" matters that Article III prohibits them from finally deciding without the consent of the parties. Unable to enter a final order itself, the bankruptcy court could be authorized to issue proposed findings and conclusions of law to the district court, but that procedure is currently only authorized for noncore matters. 28 U.S.C. § 157(c). *See below In re Lyondell Chemical Co.*, 2012 WL 1038749 (S.D.N.Y. 2012).

- Implications of *Stern v. Marshall* according to Professor Kuney:
    - Although the *Stern* Court limited its holding to the facts of the case (a state counter-claim that is not resolved in the process of ruling on proof of claim), the reasoning of the case is broad and seems to apply equally to –

        • § 157(b)(2)(A) - "matters concerning the administration of the estate;"

        • § 157(b)(2)(F) - preference avoidance and recovery;

        • § 157(b)(2)(H) - "proceedings to determine, avoid, or recover fraudulent conveyances" whether under state law incorporation through 11 U.S.C. § 544 or under § 548;, and

        • § 157(b)(2)(O) - other proceedings affecting the liquidation of the assets of the estate.

Professor Kuney states that *Stern* would also seem to apply to non-bankruptcy law counterclaims, including mandatory counterclaims arising out of the same core of operative facts, as the *Stern* dissent suggested with its example of a landlord's claim for unpaid rent and the debtor's counterclaim for breach of the lease. In *Stern*, the dissent gave the following example of a state law counterclaim which a district judge will now have to resolve under the majority's holding:

> A tenant files for bankruptcy and a landlord files a claim for unpaid rent. The tenant asserts a claim for damages suffered by the landlord's failure to fulfill his obligations as lessor and improperly recovering possession of the premises.

The state law counterclaim does not "stem from the bankruptcy itself," and it would not "necessarily be resolved in the claims allowance process." Thus in this example, under the majority's holding, a district judge would have to hear and resolve the counterclaim according to the dissent.

- Following *Stern*, if a claim is of the sort that would have been heard in courts at Westminster in 1789, then the bankruptcy court (a) lacks the power to finally determine the claim due to Article III's restrictions on Congress and (b) lacks the power to issue a report and recommendation to the district court because such procedure is only available in non-core matters, absent consent of the parties. Professor Kuney equates this with the division of power to hear matters under the Bankruptcy Act –
    - Summary jurisdiction - that is matters arising in a case under Title 11 or arising under Title 11 that were not the stuff of the courts at Westminster in 1789, which the bankruptcy courts may constitutionally hear and determine; and
    - Plenary jurisdiction - that is matters related to or arising in a case under Title 11 or arising under Title 11 that were heard by the courts at Westminster in 1789, which the bankruptcy courts may not finally adjudicate and which must be brought or finalized in federal district or state courts.
- Although Justice Roberts wrote that the *Stern* holding was narrow, the case's reasoning is so broad that each action brought under the sixteen subsections of § 157(b)(2) is subject to challenge. The issues will be: (a) consent; (b) whether the claim would have been heard by the courts at Westminster in 1789; and (c) whether the matter fits the public rights exception to the requirement of Article III judges finally adjudicating matters within the judicial power of government.
- In the first five months following *Stern*, there were 156 decisions citing the decision. It will be hard for creditors to resist bringing a *Stern* challenge given the bankruptcy courts' reputation for being fast, efficient tribunals with a perceived bias toward resolutions in favor of the bankruptcy estate.
- Following *Stern,* parties have successfully invoked same to remove final adjudication from the bankruptcy courts in the following matters --
    - § 157(b)(2)(C) - state law counterclaims that need not be resolved in the process of ruling on a creditor's proof of claim;
    - § 157(b)(2)(A) - "matters concerning the administration of the estate;"
    - § 157(b)(2)(F) - preference avoidance and recovery;
    - § 157(b)(2)(H) - "proceedings to determine, avoid, or recover fraudulent conveyances" whether under state law incorporation through § 544 or under § 548; and
    - § 157(b)(2)(O) - other proceedings.

These categories include matters that would have been plenary in nature under the Bankruptcy Act and that would have been heard by the courts at

Westminster in 1789.

- Unsuccessful challenges under *Stern* have included:
    - § 157(b)(2)(B) - challenges to allowance or disallowance proceedings;
    - § 157(b)(2)(D) - proceedings regarding the estate's obtaining credit;
    - § 157(b)(2)(E) - turnover of property of the estate;
    - § 157(b)(2)(G) - proceedings to lift or modify the automatic stay;
    - § 157(b)(2)(I)-(J) - determinations and objections to discharge or dischargability, at least apart from decisions on the underlying cause of action (e.g., state law fraud) that is the subject of the nondischargability proceeding;
    - § 157(b)(2)(K) - determinations of the validity, extent, or priority of liens;
    - § 157(b)(2)(L)- confirmation of plans;
    - § 157(b)(2)(M)-(N) - motions and orders regarding the use, sale, or lease of property; and
    - § 157(b)(2)(P) - recognition of foreign proceedings and other matters under chapter 15.

- Magistrate System - Professor Kuney questions whether *Stern* also implicates the constitutionality of magistrate judges who adjudicate matters by consent, but answers in the negative.

    - Magistrate judges operate more like adjuncts of district judges, often being housed in the same office buildings as district courts and interfacing with the public through a unified clerk's office. Justice Roberts recognized that the adjunct status of bankruptcy courts is a complete fiction given their separate courthouses and clerk's offices.

    - Magistrate judges only adjudicate matters in which parties have consented to such adjudication. Without consent, magistrate judges may handle pretrial matters, but it is the district judge that performs the final adjudication and enters judgment after considering the magistrate judge's report and recommendation de novo.

    - Applying the *Stern* analysis reveals no constitutional problem with the magistrate system because the district courts are exercising their subject matter jurisdiction through either the magistrate judge upon the parties' consent or through the district judge if the parties do not consent.

    - In bankruptcy, an unsuccessful litigant must go through the appellate process, obtain stay, etc. . .

- Because *Stern* is a decision grounded in the Article III question of what officer has the power to finally adjudicate, and not subject matter jurisdiction, the magistrate system is not implicated.

- Legislative fix or decades of litigation – Professor Kuney suggests that without a legislative fix, the bankruptcy system will face decades of litigation. Legislative suggestions include:

  - Amending 28 U.S.C. § 157(c) which currently only authorizes bankruptcy courts to submit proposed findings of fact and conclusions of law to district courts in noncore matters. By amending § 157(c) to remove the noncore limitation, bankruptcy courts could then examine each matter and determine if same would have been heard by the courts at Westminster in 1789, determine whether the parties have not sufficiently consented, and, if so, submit proposed findings rather than enter a final order.

  - Convert some or all bankruptcy judges into Article III judges. To minimize political resistance, Professor Kuney suggests a compromise where only one bankruptcy judge in each district be given Article III status with the remainder being reconstituted as magistrate bankruptcy judges.

  - Convert bankruptcy courts into special purpose magistrate courts operating as true adjuncts of the district courts, combine clerk's offices, etc. . . Although it would be difficult to consolidate the clerks' offices, Professor Kuney suggests that it may be time to confront the clear message from *Stern* that Article III judges must be the ones to finally resolve traditional suits at common law.

***See also In re Lyondell Chemical Co.**,* 2012 WL 1038749 (S.D.N.Y. 2012): In this case, the liquidation trustee brought a fraudulent transfer action under § 548 against the officers and directors involved in the prepetition merger that allegedly precipitated debtor's Chapter 11 filing. The district court held that a bankruptcy court's lack of authority to enter a final judgment on the trustee's fraudulent transfer claims against the parties involved, the vast majority of whom had not filed proofs of claim against the estate, did not serve as "cause" for permissive withdrawal of the reference.

The defendants in the bankruptcy case asked the district court to withdraw the reference on the grounds that state law claims were involved and since the defendants had not filed proofs of claim the adjudication of same was not necessary to the resolution of a proof of claim. The district court discussed in depth the old basis for withdrawal of the reference and now the new criteria in light of

Stern. The court in this instance allowed the matter to remain with the bankruptcy to issue proposed findings of facts and conclusions of law for submission to the district court and overruled the defendants' motion to withdraw the reference.

The court went on to observe that the 1984 Bankruptcy Amendments divided bankruptcy-related matters into "core" and "non-core" proceedings. 28 U.S.C. § 157(b)(1), (c)(1). Bankruptcy courts can hear both core proceedings and non-core proceedings that are "otherwise related" to a case under title 11. They can enter final judgments only in core proceedings, however, unless the parties consent. In non-core cases otherwise related to a case under title 11, bankruptcy courts are authorized to "submit proposed findings of fact and conclusions of law to the district court." § 157(c)(1).

A party can move to withdraw the reference pursuant to § 157(d). Here the defendants did not argue that withdrawal was mandatory, but rather that the reference should be withdrawn "for cause" under the permissive standard of § 157(d). Section 157(d) does not define "cause." Prior to *Stern,* however, the Second Circuit had identified a number of factors relevant to a determination of "cause" (the *"Orion* factors"), including **"whether the claim or proceeding is core or non-core, whether it is legal or equitable, and considerations of efficiency, prevention of forum shopping, and uniformity in the administration of bankruptcy law."** *See Orion Pictures Corp. v. Showtime Networks, Inc.,* 4 F.3d 1095, 1101 (2d Cir. 1993).

Under the pre- *Stern* standard, the "threshold" inquiry in evaluating a request for permissive withdrawal was whether the claim was core or non-core, because that issue determined both "questions of efficiency and uniformity," and "the relevance of parties' jury trial rights." *In re Orion,* 4 F.3d at 1101. After *Stern,* the *Lyondell* court explained that the core/non-core distinction may or may not remain relevant to a district court's withdrawal of the reference "for cause." Lyondell cited *Adelphia Recovery Trust v. FLP Group, Inc.,* 2012 WL 264180, at *3 (S.D.N.Y. Jan.30, 2012) for the proposition that following *Stern,* "a court's consideration of a motion to withdraw the reference to bankruptcy court should— *in addition* to the *Orion* factors—include consideration of" the bankruptcy court's final adjudicative authority.

Under *Stern,* it is not the core/non-core distinction but Article III that determines the bankruptcy court's adjudicative authority. Thus, *Lyondell* concluded that a district court evaluating a motion to withdraw must first determine whether or not the bankruptcy court has constitutional authority to enter final judgment on the claim, since it is on *this* issue that "questions of efficiency and uniformity" certainly turn, and "the relevance of parties' jury trial rights" may also turn. *Cf. In re Orion,* 4 F.3d at 1101. To the extent the core/non-core distinction held a privileged position among the *Orion* factors before *Stern,* this is no longer the case.

The district court disagreed with the defendants' argument that it was unclear whether the bankruptcy court could enter proposed findings of fact and conclusions of law on the fraudulent conveyance claims because § 157 recognized such actions as core. The New York court reasoned that because in *Stern* the majority stated that its holding would not change, in any meaningful way, the division of labor between bankruptcy and district courts that disallowing bankruptcy courts from issuing findings of fact and conclusions of law on core Article III claims would *significantly* change the division of labor between bankruptcy courts and district courts. As evidence, the district court stated one need look no farther than the large number of motions to withdraw the reference that have been brought before this court in the wake of *Stern,* many of which advance statutory “gap” arguments similar to those advanced here. That Congress failed to anticipate the *Stern* holding and, thus, did not properly draw the line between core and non-core proceedings, did not warrant invalidating the statutory purpose behind the grant, to bankruptcy courts, of authority to recommend findings in non-core matters related to a bankruptcy proceeding.

This case indicates that even a fraudulent conveyance action under the Bankruptcy Code is still a state law action and would be covered by *Stern.*

9 U.S.C. § 2 Validity, Irrevocability, and Enforcement of Agreements to Arbitrate.

2. CompuCredit Corp. v. Greenwood, 132 S. Ct. 665 (2012)(Ginsburg, J., dissenting). Provisions of the Credit Repair Organization Act requiring credit-repair companies to disclose to consumers their "right to sue" for violations of the CROA did not preclude enforcement of an arbitration agreement containing a class action waiver. Plaintiffs applied for and received subprime credit cards marketed by CompuCredit Corporation and issued by Columbus Bank and Trust. In their applications, plaintiffs agreed to resolve any claims by one-on-one arbitration. In 2008, plaintiffs filed a class action complaint against CompuCredit and Columbus alleging violations of the CROA. Plaintiffs' claims largely involved the defendants' allegedly misleading representations that the credit cards could be used to rebuild poor credit and their assessment of multiple fees which greatly reduced the advertised credit limit.

The district court denied defendants' motion to compel arbitration finding that "Congress intended claims under the CROA to be non-arbitrable." The Ninth Circuit affirmed.

The Supreme Court reversed finding that because the CROA is silent on whether claims under the Act can proceed in an arbitrable forum, the Federal Arbitration Act (FAA) requires the arbitration agreement to be enforced according to its terms. In relevant part, the FAA provides:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. 9 U.S.C. § 2.

This section establishes "a liberal federal policy favoring arbitration" requiring arbitration agreements to be enforced "unless the FAA's mandate has been overridden by a contrary congressional command." 132 S. Ct. at 669. The plaintiffs argued that the CROA contains such a command citing the CROA's disclosure and nonwaiver provisions. The CROA's disclosure provision requires credit repair organizations to provide consumers with a statement that reads "**You have a *right to sue* a credit repair organization that violates the Credit Repair Act."** (emphasis added) The CROA's nonwaiver provision states that any waiver cannot be enforced.

The Ninth Circuit ruled that the disclosure provision gives consumers the right to sue and because the nonwaiver provision prohibits the waiver of "any right of the consumer under this subchapter," the arbitration agreement which waived the right to bring an action could not be enforced.

The Supreme Court reversed finding that a "right to sue" does not preclude mandatory arbitration. The disclosure provision merely imposes an obligation on credit repair organizations to supply consumers with a specific statement set forth in the statute. The only right it *creates* is the right to receive the statement, which is meant to describe the consumer protections that the law *elsewhere* provides. Justice Scalia wrote that "[i]nterpreting the 'right to sue' language in § 1679c(a) to 'create' a right to sue in court not only renders it strikingly out of place in a section that is otherwise devoted to giving the consumer notice of rights created elsewhere; it also renders the creation of the 'right to sue' elsewhere superfluous." 132 S. Ct. 670. The CROA's use of terms like "action," "class action" and "court" does not mean that judicial remedies are mandated in spite of the arbitration clause. The Court explained that it is commonplace for statutes that create civil causes of action to describe the details of those causes of action in the context of a court suit. However, if the mere formulation of the cause of action in this standard fashion were sufficient to establish "contrary congressional command" overriding the FAA, valid arbitration agreements covering federal causes of action would be rare. Rather, the Court concluded that a contractually required arbitration of claims satisfies the statutory prescription of civil liability in court. When Congress has restricted the use of arbitration in other contexts, it has done so with greater clarity.

The Supreme Court found that it was clear that the mere "contemplation" of suit in any competent court does guarantee suit in all competent courts, thereby disabling parties from adopting a reasonable forum-selection clause. "And just as the contemplated availability of all judicial forums may be reduced to a single forum by contractual specification, so also can the contemplated availability of judicial action be limited to judicial action compelling or reviewing initial arbitral adjudication. The parties remain free to specify such matters, so long as the guarantee of § 1679g - *the guarantee of the legal power to impose liability* - is preserved." 132 S.Ct. at 671.

> [*Editor's note: See below Given v. M&T Bank Corp. (In re Checking Account Overdraft Litigation MDL No. 2036),* 2012 WL 934054 (11th Cir. 2012)(requiring arbitration).]

11 U.S.C. § 1222 Contents of Plan.

3. <u>Hall v. U.S. (In re Hall)</u>, 2012 WL 1658486 (U.S. 2012)(Breyer, Kennedy, Ginsburg, and Kagan, JJ., dissenting). The question before the Supreme Court was whether Chapter 12 debtors can treat capital gains taxes on the post-petition sale of farm assets as nonpriority, unsecured claims that can be discharged if the estate is insufficient to pay all claims. The Supreme Court held that capital gains tax liability arising from the post-petition sale of the debtors' farmland was not a tax liability "incurred by the estate," and was thus neither collectible nor dischargeable in the Chapter 12 plan.

Section 1222(a)(2)(A) requires a Chapter 12 plan to provide for the full payment, in deferred cash payments, of all claims entitled to priority under § 507 unless:

> the claim is owed to a governmental unit that arises as a result of the sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operation, in which case the claim shall be treated as an unsecured claim that is not entitled to priority under section 507, but the debt shall be treated in such manner only if the debtor receives a discharge[.]

Section 507 lists numerous categories of claims that receive special treatment in bankruptcy including administrative expenses allowed under § 503(b), which includes "any tax . . . ***incurred by the estate***." § 507(a)(2) and § 503(b)(B)(i). (emphasis added)

In this case, the debtors filed a Chapter 12 petition in August of 2005 and shortly thereafter moved to sell their farm for $960,000 which the bankruptcy court approved. In December of 2005, the debtors proposed a plan of reorganization under which they sought to pay off their outstanding liabilities using the proceeds from the sale. The IRS objected asserting a federal tax of $29,000 on the capital gain from the sale. The debtors amended their plan to treat the $29,000 tax as an unsecured claim to be paid "to the extent funds are available," with the balanced to be discharged. The IRS objected again and the bankruptcy court sustained the IRS's objection. The district court reversed.

The Ninth Circuit ruled that a Chapter 12 estate cannot incur tax liability. Thus, the Chapter 12 debtors could not take advantage of § 1222(a)(2)(A) to treat the capital gains tax on the post-petition sale of their farm assets as an unsecured claim. The Ninth Circuit recognized that the legislative history of § 1222(a)(2)(A) supports the debtors' argument that Congress added § 1222(a)(2)(A) to allow discharge of an administrative tax claim arising from the sale of an asset used in farming operations, but explained that recourse to legislative history is unnecessary if a statute is unambiguous. The Ninth Circuit declined to follow the Eighth Circuit's contrary holding in *Knudsen v. I.R.S.*, 581 F.3d 696 (8th Cir. 2009) finding that a Chapter 12 estate is a taxable entity and that § 1222 extinguishes the priority for capital gains tax. In *Knudsen*, the debtors sold slaughter hogs and farming equipment pre-petition, and their Chapter 12 plan called for the additional sale of equipment and land post-petition. *Knudsen* held that § 1222 could be used to render post-petition capital gains taxes unsecured.

The Supreme Court affirmed. The federal income tax liability resulting from a post-petition farm sale is not "incurred by the estate" under § 503(b) and thus is neither collectible nor dischargeable in a Chapter 12 plan.

A tax "incurred by the estate" is a tax for which the estate itself is liable. Only certain estates are liable for federal income taxes. The Internal Revenue Code defines the division of responsibilities for the payment of taxes between the estate and the debtor on a chapter-by-chapter basis. IRC § 1398 provides that when an individual debtor files for Chapter 7 or 11, the estate shall be liable for taxes. In such cases, the trustee files a separate return on the estate's behalf and the tax on the taxable income of the estate is paid by the trustee. IRC § 1399 provides that except as provided in IRC § 1398, no separate taxable entity shall result from the commencement of a bankruptcy case. Thus in Chapter 12 and Chapter 13 cases, there is no separate taxable entity.

The Supreme Court explained that these IRC provisions resolve this case. Chapter 12 estates are not taxable entities. The debtors, not the estate itself, are required to file the tax return and are liable for the taxes resulting from their post-petition farm sale. The post-petition federal income tax liability was not "incurred by the estate" and thus is neither collectible nor dischargeable in the Chapter 12 plan.

The Supreme Court explained that its holding was bolstered by the longstanding interplay between § 346 of the Bankruptcy Code and the IRC. Originally, § 346 established that state or local income taxes could be imposed only on the estate in an individual Chapter 7 or 11 case, and only on the debtor in a Chapter 13 case. Although § 346 applied to state and local taxes, Congress subsequently applied its framework to federal taxes. The BAPCPA subsequently amended § 346 and expressly aligned its assignment of state or local taxes with the rules for federal taxes. As amended, whenever the estate is separately taxable under federal income tax law, that is also the case under state or local income tax law.

Congress also added § 1222(a)(2)(A) when it enacted the BAPCPA. Section 1222(a)(2)(A) carved out an exception to the ordinary priority classification scheme, but it did not purport to redefine which claims are otherwise entitled to priority, nor alter the division of tax liability between the estate and Chapter 12 debtors. The Supreme Court recognized the longstanding rule that Congress is presumed to be aware of existing laws when it passes legislation, and stated that the existing law at the enactment of § 1222(a)(2)(A) indicated that an estate's liability for taxes turned on chapter-by chapter separate taxable entity rules.

The Supreme Court turned next to Chapter 13 and found that the established understandings holding that post-petition income taxes are not incurred by the Chapter 13 estate under § 503(b) because they are a liability of the debtor alone further bolstered the Court's holding. Further, § 1305(a)(1) which gives holders of post-petition claims the option of collecting post-petition taxes within the bankruptcy case would be superfluous if post-petition tax liabilities were automatically collectible inside a Chapter 13 case.

Although the Court recognized that there may be compelling policy reasons for treating post-petition income tax liabilities as dischargeable, Congress failed to provide for this result.

CASES PENDING DECISION IN THE SUPREME COURT
12 U.S.C. § 2607 Prohibition Against Kickbacks and Unearned Fees.

4. Freeman v. Quicken Loans, Inc., 626 F.3d 799 (5th Cir. 2010), *cert. granted*, 132 S.Ct. 397 (U.S. Oct. 11, 2011). The Supreme Court has granted certiorari in a Fifth Circuit case to determine whether RESPA bars the acceptance of undivided unearned fees where a service provider charges a borrower a fee for which no correlative service is performed. Plaintiffs each obtained a mortgage from Quicken Loans in 2007. At closing, Quicken charged each of the plaintiffs a "loan discount fee." Plaintiffs argued that a loan discount fee may only be charged when there is a corresponding interest rate reduction and that it was otherwise an unearned fee for settlement services in violation of § 8(b) of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2607(b), which reads as follows:

> **(b) Splitting charges**
> **No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.**

The plaintiffs respective state court actions were removed to federal court where they were consolidated. The district court entered summary judgment in favor of Quicken finding that plaintiffs' claims were not actionable under RESPA as the fees were not split with another party. The Fifth Circuit affirmed holding that the language of § 2607(b) is unambiguous and does not cover undivided earned fees charged by a lender.

In 2001, HUD, the agency responsible for enforcing RESPA, issued a policy statement identifying four types of overcharge schemes potentially covered by the statute:

> 1. *Fee splitting* - where two or more persons split a fee, any portion of which is unearned;
>
> 2. *Mark-ups* - where a service provider charges the borrower for services performed by a third party in excess of the cost of the services to the service provider but keeps the excess itself;
>
> 3. *Undivided unearned fees* - where a service provider charges the borrower a fee for which no service was performed; and
>
> 4. *Overcharges* - where a service provider charges a borrower for services actually performed but in excess of the reasonable value of the service performed.

The Fifth Circuit explained that all circuits agree that the statute plainly prohibits fee splitting and each circuit to have addressed the issue agrees that simple overcharges are not covered by the statute. The circuits are split however on the remaining issue of whether the statute covers mark-ups and undivided unearned fees.

Three circuits have held that the statute is exclusively an anti-kickback provision which requires two culpable parties, a giver and a receiver of the unlawful fee:

- Fourth Circuit
- Seventh Circuit, and
- Eighth Circuit.

Under this analysis mark-ups by a sole services provider are not actionable. Other circuits have rejected the two-party requirement and held that the statute prohibits mark-ups:

- Second Circuit
- Third Circuit, and
- Eleventh Circuit.[3]

Only the Second Circuit has addressed whether the statute prohibits a sole provider's undivided unearned charges and found that it did.

The Fifth Circuit disagreed finding the statutory language was unambiguous and that it did not cover undivided earned fees but requires two parties. The Fifth Circuit reasoned that the language "No person shall give and no person shall accept" would not apply to a sole actor's undivided fees. The term "and" normally requires both conditions to be satisfied and the court reasoned that its use reflected an intent to target an exchange or transaction, rather than a unilateral act. When read in its entirety, the Fifth Circuit concluded that the statute is an anti-kickback statute, not an anti-price gouging statute. Unearned fees are not kickbacks.

Finally, the court held that when read in its entirety, RESPA is an anti-kickback statute, not an anti-price gouging statute.

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[3] *See Sosa v. Chase Manhattan Mortg. Corp.*, 348 F.3d 979 (11th Cir. 2003)(finding that a single party can violate the RESPA statute prohibiting any person from giving or accepting any part of a fee unless services were actually performed).

§ 1129(b) Cram-down.

5. RadLAX Gateway Hotel, LLC v. Amalgamated , 651 F.3d 642 (7th Cir. 2011), *cert granted,* 132 S.Ct. 845 (U.S. Dec. 12, 2011). The Supreme Court granted certiorari in this case to determine whether a Chapter 11 cramdown plan proposing the sale of encumbered assets free and clear of liens at auction must provide secured creditors with the right to credit bid. In this case, two jointly administered debtors submitted proposed reorganization plans seeking to sell substantially all of their assets. The debtors proposed to sell the assets at auction to the highest bidder, with the initial bid in each auction being supplied by a stalking horse bidder. The secured creditors objected to the proposed bid procedures arguing that because the lenders had not accepted the plans and because the plans would not allow them to credit bid up to the amount of their debts at the action and, thus, would impair the creditors' interests, the plans could not be confirmed unless they satisfied the "fair and equitable" requirements for cramdown plans under § 1129(b)(2)(A) which read as follows:

> **(2)** For the purpose of this subsection, the condition that a plan be ***fair and equitable*** with respect to a class includes the following requirements:
>
> **(A)** With respect to a class of secured claims, the plan provides--
>
> **(i)(I)** that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
>
> **(II)** that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;
>
> **(ii)** for the sale, subject to section 363(k) **[allows credit bid]** of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
>
> **(iii)** for the realization by such holders of the indubitable equivalent of such claims.

(emphasis added)

The debtors argued that their plans could qualify for treatment under subsection (iii) even if they would dispose of encumbered assets in the ways discussed in subsections (i) (sales with liens attached) and (ii) (sales free and clear), but failed to meet those subsections' requirements. The Seventh Circuit held that § 1129(b)(2)(A) does not authorize debtors to use subsection (iii) to confirm a plan that seeks to sell encumbered assets free and clear of liens without providing secured creditors the right to credit bid. The Fifth and Third Circuits have taken a different approach. In *Scotia Pacific Co., LLC v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.),* 584 F.3d 229 (5th Cir. 2009), the Fifth Circuit held that a plan that proposed the sale of the debtor's encumbered assets to a specified purchaser for an amount equal to the judicially determined value of the assets qualified as fair and equitable under § 1129(a)(b)(2)(A)(iii). In *Philadelphia Newspapers*, 599 F.3d 298 (3rd Cir. 2010), the Third Circuit held, in a 2-1 decision with one of the members of the majority concurring in the judgment, that a plan that proposed selling the debtor's encumbered assets free and clear of liens in an auction where credit biding would not be allowed could qualify as "fair and equitable" under subsection (iii). Both majority opinions held that subsections (iii)'s scope was not limited by its neighboring subsections and that the proceeds from the sale of encumbered assets constituted the indubitable equivalent of the secured creditors' claims.

The Seventh Circuit concluded that the debtors' proposed plans could not be confirmed pursuant to § 1129(b)(2)(A)(iii). The court reasoned that the first two subsections established conditions to be met by reorganization plans providing for the sale of encumbered assets. The first subsection addresses plans under which a debtor seeks to retain possession of collateral or sell an encumbered asset with liens attached. The second subsection addresses plans seeking to sell encumbered assets free and clear. To read the third subsection with its general "indubitable equivalent" standard as permitting the confirmation of a plan that seeks to dispose of encumbered assets in a manner addressed by the first two subsections without meeting the requirements in the first two subsections would render those subsections superfluous. Instead, the court concluded that each subsection of § 1129(b)(2)(A) conclusively governs the category of proceedings that it addresses. Under this reading, plans can only qualify as 'fair and equitable' under (iii) if they propose to dispose of assets in ways that are not described in subsections (i) and (ii). Thus, cramdown plans that propose selling encumbered assets free and clear of liens at an auction must satisfy the requirements set forth in § 1129(b)(2)(A)(ii).

[*Editor's note:* In speaking with one of the participants in the *In re Philadelphia Newspapers*[4] case cited in *Amalgamated Bank*, the question was posed as, "what is the motive for disallowing a credit bid?" I was told that there are two explanations: (1) the party line motive, and (2) the ulterior "real motive" behind disallowing the lender to credit bid. The party line or the "debtors' line," says that a lender out of spite could continue to raise a bid over and above a genuine cash bid up to the limits of its debt and, thus, could skew the real value of the property and spoil any chance of cash coming into the estate. According to my inside source, the real motive was so that the debtors who had provided the stalking horse bid with cash could keep control of the newspaper. The apparent deal was that if the stalking horse won that is would keep the same management, employees, publisher, etc. . .

My source tells me that the party line motive is irrational because generally speaking a lender is not in the business of trying to take over and run a business, but is in the business of making money. The spite angle is simply not valid. The debtors in *Philadelphia Newpapers* were apparently trying to take advantage of the fact that the lenders with the first lien were actually a consortium of 27 different entities and the debtors knew the consortium could not come up with the money in a short amount of time to make a cash bid which ultimately would be returned to the lenders in the time allowed by the plan to auction the property. Thus, the actual motive was so that the debtors could keep control.]

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[4] 599 F.3d 298 (3rd Cir. 2010).

RECENTLY DECIDED ELEVENTH CIRCUIT CASES

§ 105 Power of Court.

6. Franken v. Mukamal (In re Creative Desperation Inc.), 449 Fed. Appx. 776 (11th Cir. 2011)(*not selected for publication)*[5](Hull, Pryor, and Black, JJ.). Franken and his law firm appealed an order of the bankruptcy court sanctioning Franken for ethical violations committed while representing the debtor. Franken argued that the bankruptcy court abused its discretion in sanctioning him, that he was denied due process, and that the bankruptcy court evidenced bias against him by mocking him at the sanctions hearing.

Federal courts possess inherent authority to impose sanctions against attorneys and their clients. This power is derived from the courts need to manage its own affairs to achieve the orderly and expeditious dispositions of cases. Further, a bankruptcy court has the authority under 11 U.S.C. § 105 to *sua sponte* take any action or make any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent abuse of process.

Abuse of discretion: The bankruptcy court did not abuse its discretion where the record revealed that Franken: (1) repeatedly sought to represent parties with directly opposing interests both in the bankruptcy action and in outside litigation; (2) submitted false and misleading documents to the court; and (3) filed several frivolous pleadings without conducting any diligence to determine their legal or factual validity.

Due process: Nor did the bankruptcy court violate Franken's due process as Franken received adequate notice of the possibility of sanctions against him and appeared at several hearings to argue in defense of his conduct. Despite numerous warnings, Franken persisted in his conduct of representing the debtor and parties with interests directly opposed to the debtor.

Bias: Franken's assertion that the bankruptcy court was biased against him was frivolous. As evidence of bias, Franken only cited the court's various rulings and one stray comment in which he felt mocked by the judge. "[J]udicial rulings alone almost never constitute a valid basis for a bias or partiality motion. . . . And even if the judge made a comment 'mocking' Franken, 'expressions of impatience, dissatisfaction, annoyance, and even anger, that are within the bounds of what imperfect men and women . . . some-times display,' do not establish bias or partiality."

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5 *See* 11th Cir. R. 36-2. Unpublished Opinions.

An opinion shall be unpublished unless a majority of the panel decides to publish it. Unpublished opinions are not considered binding precedent, but they may be cited as persuasive authority. If the text of an unpublished opinion is not available on the internet, a copy of the unpublished opinion must be attached to or incorporated within the brief, petition, motion or response in which such citation is made. But see I.O.P. 7, Citation to Unpublished Opinions by the Court, following this rule.

§ 362 Automatic Stay.

7. Jacks v. Wells Fargo Bank (In re Jacks), 642 F.3d 1323 (11th Cir. 2011)(Martin, Cox, and Black, JJ.). Mortgage lender's internal documentation on debtors' account of post-petition attorney's fees did not constitute an "act" in violation of the stay. Chapter 13 debtors filed a class action suit against Wells Fargo alleging that the mortgage lender violated the stay by failing to disclose related fees on its proof of claim. Wells Fargo's proof of claim disclosed no arrearages and did not refer to an accruing claim for attorney's fees, but an attached "Itemization of Claim and Summary of Supporting Documents" provided that "reasonable fees and costs" for the review of the bankruptcy pleadings and preparation of the proof of claim would be charged to the lender.

Post-petition Wells Fargo was invoiced for $310 by outside counsel for filing the proof of claim. Wells Fargo recorded this amount on the debtors' "Customer Account Activity Statement," but the mortgage lender never billed the debtors nor told them that they would be expected to pay the fees. The debtors sued Wells Fargo alleging that the lender had improperly charged, assessed, imposed or collected the fees without disclosing same on the proof of claim or seeking court approval. Debtors further alleged that the fees would be collected during the case, upon discharge, or upon dismissal of the case. Before certifying the class, the bankruptcy court granted summary judgment on all counts in favor of Wells Fargo and the district court affirmed.

The Eleventh Circuit affirmed as to each of the debtors' claims related to violations of the stay:

> (1) **Section 362(a)(3)** prohibits **"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."** The court of appeals explained that "unilateral accruals of amounts assertedly due, but in no manner communicated to the debtor, the debtor's other creditors, the bankruptcy court, nor any third party, plainly are not the sort of 'act' Congress sought to proscribe."
>
> (2) **Section 362(a)(5)** prohibits **"any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title."** While the debtors may face potential future liability for the charges under the terms of the mortgage, the court found that the debtors had not offered any evidence that Wells Fargo had actually undertaken any act to modify the lien. Without more, a mere potentiality of future liability cannot be considered the creation of a new and enlarged lien.
>
> (3) **Section 362(a)(6)** prohibits **"any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title."** The court first expressed doubt over whether this section, which applies to actions regarding pre-petition claims, applies to actions in connection with fees that accrued post-petition. Regardless, the court determined that the debtors' claim under subsection (a)(6) failed for the same reason as the other § 362 claims because Wells Fargo did not commit any "act" in violation of the stay.

The debtors further argued that Wells Fargo violated § 506(b) *[Determination of Secured Status]* of the Code and Rule 2016 *[Compensation for Services Rendered and Reimbursement of Expenses*] by failing to disclose the $310 fee on the proof of claim but noting the fee on its internal account. Debtors cited a line of cases holding that § 506(b) and Rule 2016 require a secured creditor to disclose and obtain approval for post-petition legal expenses. The court held that assuming that § 506(b) and Rule 2016 require disclosure of post-petition fees in some circumstances, Wells Fargo did not violate same by merely recording the costs that it had incurred while making no attempt to collect the fees or otherwise adding them to the debtors' balance owed.

The bottom line is that the creditor had committed no act to collect the debt.

As for the debtors' argument that the failure to disclose would render the fees uncollectible at any point, the court explained that the argument was not ripe for adjudication because there was no way to know whether the case would end in discharge or dismissal. The debtors complained of acts that might take place in the future.[6]

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[6] Effective December 1, 2011, newly added Bankruptcy Rule 3002.1 requires a creditor filing a proof of claim in a Chapter 13 case that has a claim secured by the debtor's principal residence to file and serve on the debtor, debtor's counsel, and trustee a notice itemizing all fees, expenses or other charges incurred post-petition. These fees can include inspection fees, late charges, and attorney fees.

§ 506(a) Allowance of Claims or Interests.

8. United States v. Oscher (In re J.H. Investment Servs., Inc.), 452 Fed. Appx. 858 (11th Cir. 2011)(*not selected for publication*)(Barkett, Marcus, and Cox, JJ.). J.H. Investment Services, Inc. ("JHIS"), engaged in a fraudulent real estate investment scheme. When the scheme fell apart, JHIS's creditors initiated an involuntary Chapter 11 case and the bankruptcy court appointed a trustee. The trustee located and sold forty parcels of real property belonging to JHIS. The bankruptcy court ordered that one percent of the sale proceeds (the carve-out fund) be set aside for JHIS's unsecured creditors totaling approximately $83,000.

The IRS filed a series of proofs of claims in the case with each one superceding the previous. The trustee objected to the third amended claim. The IRS then filed a fourth amended claim which categorized its entire $46 million claim as secured. The claim did not note a general unsecured claim nor an unsecured priority amount even though the previous claims included various unsecured and priority amounts.

In December 2009, the trustee proposed a Chapter 11 liquidating plan which expressly excluded from the carve-out fund the IRS's distribution. That same month, the trustee filed a disclosure statement indicating that the estate's assets had a value of about $750,000.

Two months later, and only a week before the confirmation hearing, the IRS objected to the plan. The IRS contended that its final amended claim asserted an unsecured claim, that the claim was allowed under § 502, and that the claim was entitled to priority under § 507(a)(8). Thus, the IRS argued, the plan violated § 1129(a)(9)(C) because it paid the carve-out fund to JHIS's general unsecured creditors before paying the IRS's priority claim in full. The trustee countered that the IRS's claim did not assert an unsecured claim, and thus, the IRS did not have one, either priority or general. The bankruptcy court agreed and ordered the carve-out fund distributed to JHIS's general unsecured creditors. The district court and Eleventh Circuit affirmed.

Although it was undisputed that the IRS was undersecured when it submitted its forth amended claim, the parties disputed whether the IRS's claim properly raised or preserved the IRS's unsecured claim. The IRS argued that § 506(a)(1) automatically bifurcated its claim into a secured and an unsecured claim and that the unsecured claim was allowed under § 502. It further agreed § 506(a)(1) also put the trustee and the other creditors on notice that the IRS would pursue its deficiency claim. Additionally, the IRS contended that even if it had to note its unsecured claim, its mistake in failing to do so should be excused as harmless.

Under the Code, a creditor must take an affirmative step to pursue an unsecured claim. No creditor, even an undersecured creditor, is required to pursue a claim in bankruptcy or file a proof of claim form. *See* § 501 (stating "[a] creditor ... *may* file a proof of claim"). The Code merely prevents nonfiling creditors from receiving distributions from the debtor's estate. *See* § 524(a). The Federal Rules of Bankruptcy Procedure further underscore this point. *See* Fed. R. Bankr.P. 3002(a) (stating that an unsecured creditor "must file a proof of claim ... for the claim ... to be allowed."); Fed. R. Bankr.P. 3003(c)(2) (stating that "any creditor who fails to [file a proof of claim] shall not be treated as a creditor with respect to such claim for purposes of voting and distribution.")

Contrary to the IRS's contention, § 506(a)(1) does not automatically assert a deficiency claim. An undersecured creditor is not required to pursue a deficiency claim. In fact, the Rules and Official Bankruptcy Forms suggest that when an undersecured creditor does not note an unsecured claim on its proof of claim, it has decided not to pursue that claim. Form 10 also permits a creditor to note a secured claim and the amount of that secured claim. However, in the same box and right next to the line for the amount of the secured claim, Form 10 asks for the amount of the claim which is unsecured. Thus, to substantially comply with Form 10, a creditor should note the portion of its claim it believes is unsecured. When an undersecured creditor does not, the trustee and other parties can conclude that the creditor has decided not to pursue its deficiency claim.

Requiring an undersecured creditor to signal its intent to pursue a deficiency claim serves an important notice function. Under § 502, a proof of claim is allowed "unless a party in interest ... objects." 11 U.S.C. § 502(a). But parties do not make objections when they do not have to.

The Code does not force creditors to pursue deficiency claims. The motive for a creditor's decision is irrelevant as far as the trustee is concerned. The trustee has no duty to ask the undersecured creditor why he elected not to pursue a deficiency claim.

§ 506(b) Interest on Oversecured Claims

9. First United Security Bank v. Garner (In re Garner), 663 F.3d 1218 (11th Cir. 2011)(Dubina, C.J., Cox, and Hunt, JJ.). Pursuant to § 506(b) an oversecured creditor is entitled to interest at the contract rate from the petition date until confirmation. Post-confirmation, an oversecured creditor is only entitled to interest at the plan rate.

In this case, the debtor's Chapter 13 plan provided for full payment of First United Security Bank's (the Bank) claim with a prime-plus present value interest rate of 4.25% per year determined under *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004). The Bank filed an objection to confirmation and argued that § 506(b) required the debtor to pay interest on its oversecured claim at the contract rate of 10.5% both pre and post-confirmation. The bankruptcy and district courts held that the Bank could only recover its contract rate from the date of filing until confirmation and required post-confirmation interest at the prime-plus rate of 4.25%. The Eleventh Circuit affirmed.

Section 506(b) is an exception to the general rule that a creditor cannot claim interest accruing on debts during bankruptcy. Section 506(b) reads as follows:

> To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose.

The sole issue on appeal was whether § 506(b) applies post-confirmation. In *Rake v. Wade*, 508 U.S. 464, 471 (1993), the Supreme Court noted that an oversecured creditor's claim for interest accrues under § 506(b) **"as part of the allowed claim from the petition date until the confirmation or effective date of the plan."** The Ninth, Second and Fifth Circuits are the only other circuits that have discussed the temporal aspect of § 506(b) and each has relied on the statement in *Rake* that § 506(b) applies only through confirmation.

The Bank argued that *Rake* was not applicable because the parties in that case agreed that § 506(b) only applied to the post-petition, preconfirmation period. The Eleventh Circuit had previously observed in dicta, however, that the parties' agreement in *Rake* did not undermine the rule that § 506(b) only applies during the preconfirmation period. (*See Telfair v. First Union Mortg. Corp.*, 216 F.3d 1333 (11th Cir. 2000)). The Bank attempted to distinguish *Telfair* on the grounds that same focused on an oversecured creditor's right to recover attorney fees under § 506(b), but the Eleventh Circuit found this distinction to be baseless. **Section 506(b) allows oversecured creditors to include post-petition interest, costs *and* fees as part of the secured claim until confirmation.** Every circuit that has discussed the temporal aspect of § 506(b) relies on the Supreme Court's statement in *Rake* that § 506(b) applies only from the date of filing through confirmation.

Interpreting § 506(b) to only apply preconfirmation is also consistent with other circuit decisions addressing the temporal scope of § 506(b) in relation to § 1325(a)(5)(B)(ii). Section 1325(a)(5)(B)(ii) provides that a court shall confirm a plan if with respect to each allowed secured claim “the value, *as of the effective date of the plan,* of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim.” The Second and Ninth Circuits have read §§ 506(b) and 1325(a)(5)(B)(ii) together to find that interest accrues under § 506(b) only until plan confirmation despite the lack of an explicit temporal limitation in § 506(b).

“The Second Circuit held that pendency interest does not run post-confirmation because ‘[o]n the date of confirmation, the allowed claim of an oversecured creditor is augmented by the inclusion of section 506(b) pendency interest. . . . Once the debtor invokes the ‘cram-down’ power of Section 1325(a)(5)(B), the creditor’s rights, including the rate of interest, are subject to modification in bankruptcy.” 663 F.3d at 1220.

The Eleventh Circuit further explained that the amount of the secured claim is set at confirmation and includes accrued post-petition contract interest under § 506(b). Section 506(b) thus defines the allowed claim of an oversecured creditor and treatment of that claim is governed by § 1325. “If a creditor accrues interest at the contract rate post-confirmation, interest upon interest would be compounded and exceed the present value of the claim under Section 1325(a)(5)(B).” *Id.* at 1221. Although dicta in *Telfair*, the Eleventh Circuit held in this case “that an oversecured creditor is only entitled to the contract rate of interest from the date of filing until confirmation of the bankruptcy plan in a Chapter 13 case where the debtor invokes the “cram down” power of 11 U.S.C. § 1325(a)(5)(B).” *Id.*

§ 506(d) Lien Avoidance Through Claims Allowance.

10. McNeal v. GMAC Mortgage LLC (In re McNeal), 2012 WL 1649853 (11th Cir. 2012)(*not selected for publication*)(Tjoflat, Edmondson, and Carnes, JJ.). The Chapter 7 debtor sought to "strip off" a second priority lien on her home pursuant to § 506(a) and (d). The debtor's home was subject to two mortgage liens: a first priority lien in the amount of $176,413 held by HSBC and a second priority lien in the amount of $44,444 held by Homecomings Financial, LLC, a subsidiary of GMAC Mortgage. The fair market value of the debtor's home was $141,416. The bankruptcy court denied the debtor's motion to strip off the junior lien concluding that § 506(d) does not permit a Chapter 7 debtor to strip off a wholly unsecured lien. The district court affirmed.

GMAC's junior lien is both allowed under § 502 and wholly unsecured pursuant to § 506(a). Section 506(d) provides that "[t]o the extent that a lien secures a claim against a debtor that is not an allowed secured claim, such lien is void." Several courts have determined that *Dewsnup v. Timm*, 502 U.S. 410 (1992) which concluded that a Chapter 7 debtor could not "strip down" a partially secured lien under § 506(d) also precludes a Chapter 7 debtor from "stripping off" a wholly unsecured junior lien.

However, the controlling precedent in the Eleventh Circuit remains the case of *Folendore v. United States Small Bus. Admin.*, 862 F.2d 1537 (11th Cir. 1989) in which the Eleventh Circuit concluded that an allowed claim that was wholly unsecured was voidable under the plain language of § 506(d).

Folendore was not abrogated by *Dewsnup*. Under the court's **prior precedent rule**, "a later panel may depart from an earlier panel's decision only when the intervening Supreme Court decision is 'clearly on point.'" Because *Dewsnup* disallowed only a "strip down" of a partially secured mortgage lien and did not address a "strip off"of a wholly unsecured lien, it is not "clearly on point" with the facts in *Folendore* or with the facts at issue in *McNeal.*

"[T]hat the reasoning of an intervening high court decision is at odds with that of our prior decision is no basis for a panel to depart from our prior decision," the court concluded. The court further noted that the Supreme Court expressly limited *Dewsnup* to the precise issue raised by the facts of the case.

§ 521 Debtor's Duties.

11. Jones v. U.S. (In re Jones), 2012 WL 833320 (11th Cir. 2012)(*not selected for publication)*(Carnes, Wilson, and Cox, JJ.). District court did not abuse its discretion in applying judicial estoppel to debtor's lawsuit against the government under the Federal Tort Claims Act. The facts of the case are as follows:

1. In 2007, the debtor filed an administrative claim against the government for $10 million in damages based on her allegation that she developed cancer from drinking contaminated water at Camp Lejeune, a marine corps base. At the time, her attorney stressed the difficulty in winning toxic tort cases.

2. In 2008, the debtor filed a Chapter 13 petition and failed to list the administrative claim.

3. In 2009, the debtor filed her FTCA lawsuit claiming $10 million in damages. The debtor did not amend her schedules to include the lawsuit.

4. In 2010, the debtor converted to a Chapter 7 case and failed to disclose the lawsuit. The bankruptcy court granted the debtor a no-asset discharge of approximately $53,000 in debts.

5. During discovery in the FTCA case, the debtor again failed to disclose the bankruptcy proceeding after the Government requested that she disclose all previous legal proceedings to which the debtor was a party. The Government later learned of the debtor's bankruptcy from her medical records.

6. In her March 2011 deposition, the debtor finally admitted that she had not disclosed the lawsuit to the bankruptcy court, stating that she had thought same was too speculative to warrant inclusion.

7. The debtor immediately thereafter sought to reopen her Chapter 7 case to add her FTCA claim.

8. The bankruptcy court granted the motion, but two days later the Government filed a motion for summary judgment in the FTCA case based on judicial estoppel.

While that motion was pending, the reappointed Chapter 7 trustee filed a motion to substitute as plaintiff in the FTCA case. The district court granted the motion for summary judgment without discussing the motion to substitute and subsequently denied same a being moot. Although the trustee did not appeal, the debtor filed a timely appeal.

The Eleventh Circuit has explained in *Burnes v. Pemco Aeroplex, Inc.,* 291 F.3d 1282, 1286 (11th Cir. 2002) that a debtor seeking shelter under the bankruptcy laws must disclose all assets and potential assets to the bankruptcy court and that this duty is a continuing one that does not end once the petition is filed. The Eleventh Circuit applies a two part test for judicial estoppel: (1) has the party previously adopted an inconsistent position under oath in a judicial proceeding, and (2) did the party intend to make a mockery of the judicial system. Here it was undisputed that the debtor adopted inconsistent positions. The debtor argued, however, that she did not have the requisite motive because she believed in good faith that her toxic tort claim had no value due to the highly speculative nature of such claims. The court of appeals rejected this argument explaining that most litigation is speculative, but if the debtor did not believe she had some chance at recovering $10 million, she would not have actively prosecuted the claim. The court concluded that the debtor had a clear motive to conceal this claim, i.e. obtaining a no-asset discharge, and that the omission was not inadvertent given that the debtor knew of the claim when she first filed her Chapter 13 proceeding and repeatedly failed to disclose same until the Government learned of the omission from other sources.

The court further found that the debtor lacked standing to challenge the district court's order denying the trustee's motion to substitute. The trustee did not appeal the order denying his motion, apparently deciding not to pursue the claim. The debtor argued that she had standing because she was a party "aggrieved by" the district court's final judgment, but a losing party does not necessarily have standing to appeal every order of the district court. Here the debtor was judicially estopped from recovering any damages. Only the trustee would have a claim for damages had the case continued. The debtor was estopped from putting herself in the position of the innocent trustee. Because the debtor was judicially estopped from recovering, she had no interest in having the trustee substituted as the plaintiff. Thus, she lacked standing to challenge the denial of the motion to substitute.

§ 523(a)(2)(A) Discharge Exception for Debts from False Representations or Actual Fraud.

12. Carlson v. Washington Mutual Bank (In re Carlson), 2012 WL 1059412 (11th Cir. 2012)(*not selected for publication*)(Dubina, C.J., Marcus, and Martin, JJ.). In January of 2005, Julie and Gary Carlson sought a home mortgage refinance loan from Washington Mutual Bank in the amount of $2,090,000. When a title search revealed second and third mortgages in the amount of $250,000 and 500,000, Washington Mutual conditioned the refinance loan upon its obtaining priority status as the first mortgagee. The Carlsons made written representations that the junior mortgages were satisfied or would be satisfied. At closing, two satisfactions of mortgage were presented, but Washington Mutual subsequently discovered that the satisfactions were forgeries. After refinancing, the Carlsons moved to Florida and defaulted on the $500,000 note. Following a sheriff's sale in December of 2006, Washington Mutual redeemed the property and suffered a $1.1 million loss.

In May of 2007, Julie Carlson filed a Chapter 7 petition. Washington Mutual filed a complaint in the bankruptcy court against Julie and Gary. Washington Mutual sought to have Julie's debt determined nondischargeable under § 523(a)(2)(A), § 523(a)(2)(B), and § 523(A)(6). Washington Mutual also sought damages against Julie and Gary for fraud/misrepresentation and breach of contract. In December of 2008, the bankruptcy court denied the Carlsons' motion for summary judgment and the district court denied their motion for leave to appeal that order.

In the spring of 2011, after the referral of the case to the district court, the Carlsons filed a motion to continue the trial due to Gary's health limitations. The district court denied the motion and after a bench trial, entered final judgment in favor of Washington Mutual against both for $1,270,237.47 in damages and ruled that Julie's debt was nondischargeable.

Res Judicata: The Carlsons argued that because they and Washington Mutual were parties to a Minnesota state court lawsuit concerning the same loans, res judicata barred this adversary proceeding. However, it was undisputed that the state court proceeding did not dispose of any claim raised in the adversary and cross claims are not compulsory in Minnesota state courts. Further, any state court would lack jurisdiction over the nondischargeability claims.

Subject matter jurisdiction over state law claims against Gary: Gary argued that the bankruptcy court lacked subject matter jurisdiction over the claims against him because he was not a debtor and the outcome of the claims would have no effect on Julie's bankruptcy estate or her discharge. The Eleventh Circuit held that the bankruptcy court had related to jurisdiction under 28 U.S.C. § 1334(b) where the outcome of the complaint against Gary conceivably could have affected Julie's liabilities, her rights in jointly owned assets, and the bankruptcy estate's administration. Additionally, the district court had federal question jurisdiction over the nondischargeability claims and diversity jurisdiction over the state law claims.

Denial of summary judgment not reviewable: The Supreme Court recently upheld the rule that an appellate court will not review the pretrial denial of a motion for summary judgment after a full trial and judgment on the merits.

Motion to continue: There is a four part test for determining whether a court abused its discretion in denying a continuance. Courts should consider: (1) the extent of the appellant's diligence in preparing his or her defense before the hearing date; (2) the likelihood that the need for a continuance would have been met had the continuance actually been granted; (3) the extent to which the continuance would have burdened the court, the opposing party, and its witnesses; and (4) the extent to which the appellant suffered harm because of the court's denial. Here, the court reasonably determined the Carlsons had ample time to ready a defense, (2) Gary would not have been better prepared for trial after a 90 day continuance, and (3) the continuance would have burdened the plaintiff. Moreover, the court admitted Gary's deposition testimony as evidence.

§ 523(a)(4) Discharge Exception for Fiduciary Debts, Embezzlement, or Larceny.

13. Bullock v. BankChampaign (Bullock), 670 F.3d 1160 (11th Cir. 2012)(Barkett, Pryor, and Bucklew, JJ.)(time to petition Supreme Court for certiorari ends June 16, 2012). The court of appeals affirmed the bankruptcy and district courts' determinations that an Illinois judgment debt owed to the bank was not dischargeable pursuant to § 523(a)(4) and adopted the objectively reckless standard for purposes of determining defalcation under § 523(a)(4), which reads:

> **(a) A discharge under 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –**
>
> * * * *
>
> **(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny[.]**

In 1978, the debtor became the trustee of his father's trust with the sole asset being a life insurance policy on the father's life. Despite provisions in the trust limiting his ability to borrow from the trust to two situations, namely, to pay the life insurance premiums and to satisfy a beneficiary's request for withdrawal, the debtor borrowed from the trust by making three loans secured by the policy's cash value. First, at the request of his father, the debtor borrowed more than $117,000 for his mother to use to repay a debt owed to the father's business. Second, the debtor borrowed some $80,000 to purchase certificates of deposit which he and his mother eventually used toward the purchase of a garage fabrication mill in Ohio. Third, the debtor borrowed just over $66,000 so that he and his mother could purchase real estate. All of the loans were repaid in full.

After the debtor's two brother learned of the trust, they filed a suit against the debtor in Illinois state court alleging the debtor had breached his fiduciary duty as trustee by engaging in self-dealing via the three loans. In 2002, the Illinois state court granted summary judgment in favor of the brothers finding that it could not be "disputed the loans made by [Bullock] while acting as trustee are considered self-dealing transactions. All of the loans were made to entities [Bullock] had a financial interest in or to a relative." In a subsequent order awarding damages, the state court stated that the court **"has already determined that the Defendant, while acting as trustee, breached his fiduciary duties."** Although the state court found that the debtor did **"not appear to have had a malicious motive in borrowing funds from the trust," the court concluded that "neither the facts and circumstances surrounding the loans nor the motives of [Bullock] can excuse him from liability."** The state court entered judgment against the debtor in the amount of $285,000.

In 2009, Bullock filed for Chapter 7 in Alabama in the hopes that he could discharge the judgment debt. The bank filed a complaint under § 523(a)(4) to determine the dischargeability of the debt. The bankruptcy court granted summary judgment in favor of the bank finding that Bullock was collaterally estopped from attacking the Illinois judgment based upon the state court's finding that the debtor had breached his fiduciary duty by engaging in self-dealing. The bankruptcy court concluded that such conduct amounted to fraud and defalcation for purposes of § 523(a)(4) and applied collateral estoppel. The district court affirmed.

Section 523(a)(4) provides that debts arising from "fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny" are not dischargeable in bankruptcy. The issue on appeal was whether the bankruptcy court correctly characterized Bullock's conduct as fraud and/or defalcation under § 523(a)(4).

The Eleventh Circuit has held that "[d]efalcation refers to a failure to produce funds entrusted to a fiduciary" and that "the precise meaning of 'defalcation' for purposes of § 523(a)(4) has never been entirely clear." *Quaif v. Johnson*, 4 F.3d 950, 955 (11th Cir. 1993). In deciding *Quaif*, the court of appeal referred to the Second Circuit's decision in *Central Hanover Bank & Trust Co. v. Herbst*, 93 F.2d 510 (2nd Cir. 1937), as containing the best analysis of the meaning of "defalcation" under § 523(a)(4). In *Central Hanover*, the Second Circuit opined that whatever the original meaning of defalcation "it must here have covered other defaults than deliberate malversations, else it added nothing to the words, 'fraud or embezzlement." The *Central Hanover* case found that "the misappropriation must be due to a known breach of duty, and not to mere negligence or mistake. Although [misappropriation] probably carries a larger implication of misconduct than defalcation, defalcation may demand some portion of misconduct . . .." The Second Circuit ended stating, "[a]ll we decide is that when a fiduciary takes money upon a conditional authority which may be revoked and knows at the time that it may, he is guilty of defalcation though it may not be a fraud, or an embezzlement, or perhaps not even a misappropriation." In *Quaif*, the Eleventh Circuit interpreted *Central Hanover* as standing for the proposition that a defalcation under § 523(a)(4) does not have to rise to the level of fraud, embezzlement, or misappropriation.

There is a split of authority among the circuits regarding the meaning of defalcation under § 523(a)(4):

- Fourth, Eighth, and Ninth Circuits
  - Even an innocent act by a fiduciary can be a defalcation;
  - Intentional wrongdoing not required;
  - Intent to defraud not required.
- Fifth, Sixth, and Seventh Circuits (now joined by the Eleventh Circuit)
  - Require a showing of recklessness by the fiduciary;
  - Actual intent not required, it is a recklessness standard;
  - Defalcation requires more than negligence, instead the fiduciary must have been objectively reckless in failing to properly account for or allocate funds.
- First and Second Circuits[7]
  - Require a showing of extreme recklessness;
  - Conscious misbehavior or extreme recklessness.

After reviewing the views of its sister circuits and based on its prior alignment with the *Central Hanover* decision, the Eleventh Circuit aligned itself with the Fifth, Sixth, and Seventh Circuits finding that § 523(a)(4) requires more than mere negligence. Instead, defalcation requires a known breach of a fiduciary duty, such that the conduct can be characterized as objectively reckless.

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[7] Interestingly, the Second Circuit no longer follows *Central Hanover*, although it now constitutes the basis of the Eleventh Circuit's position.

Applying the objectively reckless standard, the court of appeals concluded that the bankruptcy court correctly determined that Bullock committed a defalcation by making the three loans while he was the trustee of his father's trust. As trustee he should have known that he was engaging in self-dealing given that he knowingly benefitted from the loans. Thus, his conduct could be characterized as objectively reckless.

§ 523(a)(5) Discharge Exception for Debts from Alimony, Maintenance, or Support.

14. Benson v. Benson (In re Benson), 441 Fed. Appx. 650 (11th Cir. 2011)(*not selected for publication)*(Tjoflat, Carnes, and Kravitch, JJ.) When Sally and Todd Benson divorced, they agreed that Todd would pay the mortgage on their home, which Sally would keep. Todd ultimately stopped making the payments, filed a petition under Chapter 13 of the Bankruptcy Code and sought to discharge the obligation under the property settlement agreement they made when they divorced. Sally objected and argued that the mortgage payments were a non-dischargeable domestic support obligation ("DSO"). Both the bankruptcy court and district court agreed with Sally and Todd appealed.

In a Chapter 13 bankruptcy, a debtor post-BAPCPA can still discharge property settlements, but cannot discharge a DSO. A DSO is defined at § 101(14A) **as a debt owed to a former spouse that was incurred as a result of a property settlement agreement that is "*in the nature of* alimony, maintenance, or support . . . [of that former spouse] *without regard to whether such debt is expressly so designated*."** (emphasis added). Under the precedent of *Cummings v. Cummings*,[8] in making such a determination courts are directed to look at the following factors:

(1) the agreement's language;
(2) the parties' financial position when the agreement was made;
(3) the amount of the division;
(4) whether the obligation ends upon death or remarriage of the beneficiary;
(5) the frequency and number of payments;
(6) whether the agreement waives other support rights;
(7) whether the obligation can be modified or enforced in state court; and finally
(8) how the obligation is treated for tax purposes.

In this case, the court of appeals determined that the language of the property settlement agreement supported Sally's contention that the parties intended the mortgage payments to be a domestic support obligation where: (1) Sally waived any right to claim alimony in consideration for the benefits received under the agreement; (2) the agreement required Todd to maintain life insurance sufficient to cover the mortgage obligation; (3) the agreement provided that Todd could claim a tax exemption for the minor children as long as he paid the mortgage which made the payment appear to be child support; (4) the state court found Todd in contempt upon failure to pay the mortgage; and (5) Sally had not worked outside the home for at least a decade at the time of the agreement.

[8] 244 F.3d 1263, 1265 (11th Cir. 2001).

§ 523(a)(6) Discharge Exception for Willful and Malicious Acts.

15. Maxfield v. Jennings (In re Jennings), 670 F.3d 1329 (11th Cir. 2012)(Barkett, Bryor, and Kravitch, JJ.). The facts of this case are as follows:

1. In May 2001, Maxfield sued Bruce Jennings and two companies that he controlled for personal injuries sustained by a gun manufactured and distributed by the companies.

2. In December of 2001, Maxfield filed an amended complaint to add the debtor, Janice Jennings (Bruce's second ex-wife), Anna Leah Jennings (Bruce's third ex-wife), and RKB Investments as defendants in the personal injury action. Maxfield sought to hold them liable under joint venture, partnership, and alter-ego theories.

3. RKB is a partnership created by Bruce and the debtor who acted as co-trustees of three trusts that were partners in RKB. RKB held title to a piece of unencumbered property valued at $3.9 million. In February of 2002, RKB conveyed the unencumbered property to Bruce Jennings' third ex-wife without any consideration.

4. When Maxfield found out about the transfer, he filed a second complaint in state court against the debtor and the joint venture to set aside the fraudulent transfer.

5. In May of 2003, the plaintiff obtained a verdict against the ex-husband for $24 million in California state court. At the time of the verdict, there had been no determination in the fraudulent conveyance action.

6. Thereafter, the debtor and her ex-husband filed Chapter 11 bankruptcy proceedings and the debtor-wife's case was eventually converted to Chapter 7. The fraudulent conveyance action was removed to bankruptcy court.

7. In 2007, the bankruptcy court concluded that the debtor-wife and ex-husband had conspired in the fraudulent transfer of the unencumbered property and she was, therefore, severally liable for the damages to the ex-husband's creditors in the amount of $3.9 million. The bankruptcy court specifically found that the debtor-wife knew that the ex-husband was a defendant in the personal injury case when the conveyance was made, that the conveyance was made without consideration, and with intent to keep the property out of the hands of his creditors.

8 Thereafter, the creditor filed a complaint for nondischargeability against the debtor-wife in bankruptcy under § 523(a)(6) for the amount of the transferred property. The bankruptcy court granted summary judgment in favor of her finding that the debtor's participation in the conspiracy was not substantially certain to cause injury to the creditor because the transfer occurred over a year before he obtained a judgment in the personal injury action. The creditor appealed arguing that he had a cognizable interest in the transferred property at the time of transfer sufficient to establish that the debtor's actions were substantially certain to cause him injury. The district court agreed and directed the bankruptcy court to enter judgment in favor of the creditor. The debtor appealed.

The issue before the Eleventh Circuit was whether the debtor willfully and maliciously injured the creditor or his property under § 523(a)(6). Because the creditor obtained a fraudulent transfer judgment complete with a finding that the debtor intended to prevent the creditor from satisfying his personal injury claim, the Eleventh Circuit concluded that the transfer was an injury to the creditor's property, thus the exception to discharge for willful and malicious injury by a debtor to the property of another applied.

The Eleventh Circuit has held that the proof of "willfulness" requires a "showing of an intentional or deliberate act, which is not done merely in reckless disregard of the rights of another." A debtor is responsible for a 'willful' injury when he or she commits an intentional act the purpose of which is to cause injury or which is substantially certain to cause injury. Here the evidence revealed that the debtor acted willfully in preventing the judgment creditor from reaching the unencumbered property to satisfy part of his personal injury judgment. The debtor knew that the purpose of the transfer was to keep the property out of the reach of creditors. She was acutely aware of the creditor's personal injury claim because she, the co-defendant, and their trust were named as defendants in the suit just three months before the transfer. The debtor admitted these facts despite her later testimony to the contrary.

Malicious means "wrongful and without just cause or excessive even in the absence of personal hatred, spite or ill-will." A showing of specific intent to harm another is not necessary. Here the debtor had no just cause to effect the transfer. She knew that the third party to whom the property was transferred had no claim to the property and she knew that her co-defendant had no legitimate reason to transfer same to the third party. She effected the transfer without just cause, and therefore did so with malice.

§ 548(a) Fraudulent Transfers.

16. Senior Transeastern Lenders v. Official Comm. of Unsecured Creditors (In re TOUSA, Inc.), 2012 WL 1673910 (11th Cir. 2012)(Tjoflat, Pryor, and Fay, JJ.). The Eleventh Circuit affirmed a bankruptcy court's findings that debtor-subsidiaries (Conveying subsidiaries) did not receive reasonably equivalent value in exchange for liens conveyed to new lenders.

Factual background:

1. As of 2006, TOUSA, Inc. was the thirteenth largest homebuilding enterprise in the country. TOUSA grew rapidly by acquiring independent homebuilders that became subsidiaries of TOUSA. The Conveying subsidiaries owned most of the assets of the enterprise and generated virtually all of its revenue.

2. To finance its growth, TOUSA issued more than $1billion of unsecured public bonds which were guaranteed by the Conveying subsidiaries. TOUSA also borrowed $224 million under a revolving line of credit for which the Conveying subsidiaries were jointly and severally liable.

3. Both the bond debt and revolving line of credit agreements provided that an adverse judgment exceeding $10 million against TOUSA or the Conveying subsidiaries or a bankruptcy filing by either would constitute an event of default.

4. In June of 2005, TOUSA entered into a joint venture with a third party to acquire homebuilding assets owned by Transeastern Properties, Inc. TOUSA incurred more debt from the "Transeastern Lenders" to fund the joint venture, but none of the Conveying subsidiaries guaranteed the debt.

5. Following a downturn in the housing market, the joint venture defaulted. In December of 2006, the Transeastern Lenders sued TOUSA alleging $2 billion in damages.

6. In July of 2007, TOUSA executed a settlement with its joint venture partner and the Transeastern Lenders requiring TOUSA to pay the Transeastern Lenders $421 million. To finance the settlement, Citicorp North America, Inc. agreed to syndicate two new loans to TOUSA and the Conveying subsidiaries totaling $500 million. The new loans were secured by liens on the assets of the Conveying subsidiaries. The loan agreements with the "New Lenders" required a portion of the funds be used to pay the $421 million settlement to the Transeastern Lenders, with the balance of the funds beings used to pay professional fees.

7. Six months later, TOUSA and the Conveying subsidiaries filed Chapter 11 petitions.

Bankruptcy and district court proceedings:

1. The unsecured creditor's committee filed an adversary proceeding against the New Lenders and the Transeastern Lenders to avoid as a fraudulent transfer the transfer liens to the New Lenders under § 548(a)(1)(B) and to recover the value of the liens from the Transeastern Lenders pursuant to § 550(a)(1) as the entities "for whose benefit" the transfer was made.

2. Both set of lenders argued that the transfer of the liens was not fraudulent because the Conveying subsidiaries had received **"reasonably equivalent value"** in exchange for their liens in the form of the economic benefit of avoiding default and immediate bankruptcy. Alternatively, the Transeastern Lenders argued if the transfer was fraudulent, they could not be held liable as entities **"for whose benefit the transfer was made"** because they were subsequent transferees of the loan proceeds from TOUSA, not entities that benefitted immediately from the transfer.

3. The bankruptcy court ruled in the committee's favor, avoided the transfer as fraudulent under § 548, ordered the joint venture lenders to disgorge a portion of the funds received, and awarded damages to the committee. Section 548(d)(2)(A) defines the term **"value"** as being **"property or satisfaction or securing of a present or antecedent debt of the debtor[.]"** The bankruptcy court determined that the Conveying subsidiaries could not receive 'property' unless they obtained some kind of enforceable entitlement to some tangible or intangible article. Because the Conveying subsidiaries did not receive any property, they did not receive reasonably equivalent value according to the bankruptcy court.

4. Alternatively, the bankruptcy court found that: (1) Even if all the benefits highlighted by the lenders were legally cognizable, their value considered as a whole fell short of reasonably equivalent; (2) An earlier bankruptcy for TOUSA would not have seriously harmed the Conveying subsidiaries, therefore delaying the ultimate filing did not constitute reasonably equivalent value; (3)Even if all TOUSA entities would have spiraled immediately into bankruptcy without the transfer, the transfer was still the most harmful option; (4) Internal documents revealed that TOUSA insiders realized that the liability of the company to the Transeastern Lenders could force TOUSA into bankruptcy even before the transfer was approved.

5. The district court reversed finding the bankruptcy court had too narrowly defined "value" and cited a Third Circuit case holing that "[t]he mere 'opportunity' to receive an economic benefit in the future constitutes 'value' under the Code." The district court concluded that the indirect benefits, including the opportunity to avoid bankruptcy court constituted "value" under the § 548(a). The district court also held that the Transeastern Lenders could not be liable as entities for whose benefit the transfer was made because they did not benefit from the transfer of the liens to the New Lenders, but were instead subsequent transferees of the proceeds backed by the liens.

Eleventh Circuit findings:

1. **The Conveying subsidiaries did not receive reasonably equivalent value in exchange for the liens transferred to the New Lenders.** Section 548(a)(1)(B) provides for the avoidance of "any transfer . . . of an interest of the debtor in property, or any obligation . . . incurred by the debtor, that was made or incurred on or within two years before the" petition date if the debtor **"received less than reasonably equivalent value in exchange for"** the transfer or obligation, and the debtor (1) "was insolvent on the date such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;" (2) "was engaged in business or a transaction,

or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;" or (3) "intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured." There was no dispute that the Conveying subsidiaries were either insolvent or unable to pay their debts when the liens were conveyed. The issue was whether they received less than "reasonably equivalent value."

The Eleventh Circuit declined to decide whether the possible avoidance of bankruptcy can confer "value" because the bankruptcy court found that even if all the purported benefits of the transaction were legally cognizable, they did not confer reasonably equivalent value in this instance. Whether a fair consideration has been given for a transfer is largely a question of fact. Here the record supported the bankruptcy court's findings that for the Conveying subsidiaries, the almost certain costs of the transaction far outweighed any perceived benefits. The bankruptcy court's findings included that the new loan transaction at most delayed the debtors' inevitable bankruptcies, and the benefits to the Conveying subsidiaries were not close to be reasonably equivalent in value to the $403 million of obligations that they incurred.

The lenders attacked this finding as ruling in "hindsight" and argued that the downturn in the housing market could not have been predicted. However, the bankruptcy court's findings were based on a through review of public knowledge available before the transfer occurred and statements made by TOUSA insiders predicting the companies downfall if the transaction went forward before same was approved. The Eleventh Circuit found that the bankruptcy court correctly asked, "based on the circumstances that existed at the time the investment was contemplated, whether there was any chance that the investment would generate a positive return." The record supported the negative answer found by the bankruptcy. The Eleventh Circuit concluded that "**[t]he opportunity to avoid bankruptcy does not free a company to pay any price or bear any burden.**"

2. **The Committee was entitled to recover from the Transeastern Lenders under § 550(a)(1).** If a transfer is avoided under § 548, § 550(a)(1) allows the recover of the property transferred or its value from the initial transferee. The court of appeals rejected the subsequent transferee argument finding that the loan agreements required the proceeds of the loans secured by the liens be transferred to the Transeastern Lenders and the settlement was expressly dependent upon the new loans.

The Transeastern Lenders argued that the funds passed from the New Lenders to a wholly-owned subsidiary of TOUSA before the funds were paid to the Transeastern Lenders, but the subsidiary that wired the money to the Transeastern Lenders did not have control over the funds. The loan documents required the subsidiary to wire the funds to the Transeastern Lenders immediately. Although the funds technically passed through the TOUSA subsidiary, this did not make the Transeastern Lenders subsequent transferees of the funds because TOUSA never had control over the funds.

Finally, the Eleventh Circuit remanded for the district court to review the remedies ordered by the bankruptcy court.

§ 548(c) Good Faith Defense.

17. Perkins v. Haines (In re International Mgmt. Assocs., LLC), 661 F.3d 623 (11th Cir. 2011)(Edmondson, Martin, and Hodges, JJ.). In this case, the Eleventh Circuit determined that good faith investments in a debtor's Ponzi scheme are "for value" under § 548(c) up to the amount of investment, but not for profits interest. The plan trustee argued that § 548(c) did not apply because the investors here purchased equity interests in the debtor which perpetrated the Ponzi scheme. The Eleventh Circuit held that the purchase of equity interest investments in a Ponzi scheme are for value up to the amount of principal "regardless of whether the good faith investors have an equity interest in, or some other form of claim against, the legal entity constituting the instrument of fraud."

The plan trustee filed several adversary proceedings seeking to avoid and recover as fraudulent transfers, distributions that had been made to investors that had made capital contributions to the debtors. These distributions represented returns of principal and/or purported profits on the investors' equity investments.

The investors asserted an affirmative defense under § 548(c) which applies when a transferee acts in good faith and gives "value to the debtor in exchange for such transfer. . . ." Section 548(c) reads as follows:

> **(c) Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545, or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.**

The bankruptcy court denied the trustee's motion for partial summary judgment and the Eleventh Circuit certified the matter for direct appeal.

The general rule in Ponzi schemes is that a defrauded investor gives 'value' to the debtor in exchange for a return of the principal amount of the investment, but not as to any payments in excess of principal. Defrauded investors are recognized as having a claim for fraud against the debtor. Thus, any transfer up to the amount of the principal investment satisfies the investor's fraud claim and is made for value in the form of the investor's surrender of his or her tort claim. While such payments are not recoverable by a plan trustee, any transfers over and above the amount of the principal are not made for value and may be subject to recovery.

Here, the plan trustee argued the exception did not apply because the investors held an equity interest in the insolvent debtors. The trustee cited a line of cases holding that transfers to redeem an equity investment in an insolvent entity (initially made free of fraud) cannot constitute a transfer for value. The cases cited by the trustee involved investors exchanging shares of stock for other security interests at a time when the corporations were insolvent. The cases cited by the trustee held that these exchanges constituted fraudulent transfers because the stock was worthless due to corporate insolvency.

The Eleventh Circuit distinguished these cases because none of them involved Ponzi schemes. "Stated differently, none of the stockholders in those cases were fraudulently induced into making their initial investments so that none possessed fraud claims that would be satisfied in whole or in part by virtue of the later transfers." The Eleventh Circuit refused to focus solely on the form of the investment , stating "[N]o court has distinguished between equity investments and debt-based claims when applying the general rule to fraudulent transfer actions arising out of a Ponzi scheme." To the contrary, the only circuit to have addressed the issue (*AIF Holding, Inc.*, 525 F.3d 700 (9th Cir. 2008)) applied the general rule to equity investors in a Ponzi scheme and rejected any attempts to distinguish between the forms of the investment.

§ 727(a)(4) Denial of Discharge for False Oath or Account.

18. Phillips v. Epic Aviation (In re Phillips), 2012 WL 1071270 (11th Cir. 2012)(*not selected for publication)*(Tjoflat, Edmondson, and Marcus, JJ.). The bankruptcy court denied the debtor's discharge under § 727(a)(4)(A) for making false oaths in connection with his official bankruptcy schedules and the statement of financial affairs ("SOFA"). The district court affirmed. The debtor failed to disclose the following:

> 1. an undocumented transaction in the amount of $50,000 that occurred approximately four months pre-petition;
>
> 2. $23,000 in attorney payments; and
>
> 3. an interest in a $3,090 security deposit.

On appeal, the debtor argued that the bankruptcy court erred by applying a reckless standard instead of a "knowingly and fraudulently" standard to the false statements and omissions. The debtor also argued that he had no obligation to disclose the transactions at issue.

Knowingly and Fraudulent: Under § 727(a)(4)(A), a discharge should not be granted if the debtor "knowingly and fraudulently, in or in connection with the case . . . made a false oath or account." A party objecting under § 727(a)(4)(A) must prove by a preponderance of the evidence that the false oath was fraudulent and material. The debtor argued that the bankruptcy court applied a "willfulness" or "recklessness" standard, and that it failed to make express findings of actual fraudulent intent. However, the bankruptcy court specifically stated that § 727(a)(4)(A) "requires a finding of actual intent to defraud . . . Only deliberate omissions qualify as false oaths justifying denial of discharge." The court further stated that "the facts and circumstances clearly warrant a finding that the Debtor had actual fraudulent intent when he omitted these interests and transfers." Accordingly, there was no basis to conclude that the bankruptcy court denied the debtor's discharge based solely on the court's additional findings that the debtor "chose to play 'fast and loose' with his disclosure obligations." A false oath is generally proven by circumstantial evidence or inferences drawn from circumstances surrounding the debtor. Thus, a bankruptcy court is entitled to look to the totality of the circumstances including the recklessness of a debtor's behavior to infer whether a debtor submitted a statement with intent to deceive.

Undocumented transfers must be disclosed: Question 10 of the SOFA required the debtor to: "List all other property, other than property transferred in the ordinary course of the business or financial affairs of the debtor, transferred either absolutely or as security within two years immediately preceding the commencement of this case." It was undisputed that the debtor paid $100,000 for something known as the "Englewood Project," and that he transferred same to a third party for $50,000 approximately four months before he filed bankruptcy. Thus, the transaction had recently occurred when the debtor filed bankruptcy, it gave the debtor $50,000 when he was financially troubled, and the debtor suffered a significant loss on his original $100,000 investment. Accordingly, the bankruptcy court did not err in finding that the debtor, who was a sophisticated and educated businessperson, knew that he had some sort of interest in the real estate due to his $100,000 investment and that he transferred that interest to a third party in exchange for $50,000.

Payments to attorneys not in the ordinary course had to be disclosed: The debtor made $23,000 in payments to various attorneys to represent him in litigation involving the bankruptcy proceedings of a company in which the debtor was the principal. These payments were not in the ordinary course of business because the debtor's business was the charter air business, not litigation. Moreover, the debtor disclosed a payment to another attorney so he knew he had a duty to disclose.

Materiality of Omission: The debtor argued that his failure to disclose an interest in a $3,090 security deposit was not fraudulent because it was immaterial. An omission is material "it if bears a relationship to the bankruptcy's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of his property." Materiality is not based on an assets relative value to the overall estate. Creditors are entitled to judge for themselves what will benefit, and what will prejudice them.

§ 1328 Effect of Confirmation.
19. State of Florida Dept. of Rev. v. Diaz (In re Diaz), 647 F.3d 1073 (11th Cir. 2011)(Dubina, C.J., Hill and Ebel, JJ.): As a matter of first impression, the Eleventh Circuit held that interest on a child-support obligation that accrues post-petition is nondischargeable and may be collected personally against the debtor after the debtor receives a Chapter 13 discharge. In this case, the debtor received a discharge in November of 2005. The bankruptcy court reopened the case in December of 2008 to determine whether the Florida Department of Revenue (DOR) violated the stay by sending the debtor two collection notices during the bankruptcy and whether both the Florida DOR and the Virginia Department of Social Services (DSS) violated the discharge injunction by trying to collect past-due child support after the discharge.

During the bankruptcy, the Florida DOR filed a proof of claim in the amount of $67,047.45 to enforce a Virginia child support order. The claim included $20,000 in accrued pre-petition interest. The debtor objected to the claim on the ground that he only owed $47,746.49. The Florida DOR failed to respond and the bankruptcy court sustained the objection. The debtor amended his plan to pay for the reduced claim in full and the bankruptcy court entered an order confirming the amended plan. The debtor completed his plan payments and received his discharge. The discharge order explained that a Chapter 13 discharge extinguishes the debtor's legal obligation to pay any debt that is discharged. It further explained that "[m]ost, but not all, types of debts are discharged if the debt is provided for by the chapter 13 plan or is disallowed by the court." Finally, it listed common types of debts that are *not* discharged in a Chapter 13 case, including "[d]ebts that are in the nature of alimony, maintenance, or support."

Post-petition, the Florida DOR and the Virginia DSS initiated collection proceedings against the debtor to collect both the disallowed pre-petition interest and the accrued post-petition interest. The bankruptcy court held the agencies in contempt for wilfully violating the stay and the discharge injunction. The district court affirmed.

The Chapter 13 confirmation order did not discharge either the pre-petition interest nor the post-petition interest on the child-support debt even though the bankruptcy court had entered a final order determining the amount of child-support to include principal only. The disallowed portion of the State's claim was not discharged. **Disallowance of a claim and nondischargeability are separate issues**. Although a creditor whose claim is disallowed may not collect from the bankruptcy estate, disallowance of a claim does not necessarily discharge the underlying debt and eliminate the debtor's personal liability. Section 1328(a)(2) provides that a "debtor is discharged of all debts **provided for by the plan or disallowed** under section 502 of this title, ***except*** any debt – (2) of the kind specified . . . in paragraph (5) of section 523(a) of this title[.]" "Thus, if a creditor holds a child-support debt, then whether the bankruptcy court disallows all, part or even none of that creditor's claim has no bearing on whether any portion of the debt is discharged." *See also United Student Aid Funds, Inc. v. Espinosa*, 130 S.Ct. 1367, 1379 n.10 (2010) observing that a child-support debt is "not dischargeable under *any* circumstances" in Chapter 13. Finding no reason to distinguish post-petition interest on a tax debt from post-petition interest on a child-support debt, the court further held that "post-petition interest, as an integral part of the nondischargeable child support obligation, is also nondischargeable and may be collected personally against the debtor" after discharge. *Id.* at n 14.

9 U.S.C. § 2 Validity, Irrevocability, and Enforcement of Agreements to Arbitrate.

20. Given v. M&T Bank Corp. (In re Checking Account Overdraft Litigation MDL No. 2036), 2012 WL 934054 (11th Cir. 2012)(Carnes, Pryor, and Kravitch, JJ.). An account holder brought a putative class action against M&T Bank, alleging that the bank had charged excessive overdraft fees on debit card transactions. After the actions were consolidated into multidistrict litigation, the district court denied the bank's motion to compel arbitration. The Eleventh Circuit vacated and remanded, and the bank renewed its motion to compel arbitration.

The district court denied the motion finding that because the account holder sought, in part, injunctive relief, her claims were not within the scope of the parties' arbitration agreement. The bank argued that the district court erred by deciding whether the claims were within the scope of the arbitration agreement, arguing that an arbitrator should have decided that question.

The account holder's contract included an arbitration agreement that obligates the parties to submit "[e]ach dispute or controversy that arises out of or is related to [her checking] account ... [to] binding arbitration." The Eleventh Circuit held that through the delegation provision of their arbitration agreement, the parties manifested their intent to arbitrate whether the account holder's claims were within the scope of the arbitration agreement. The delegation provision reads as follows:

> **Any issue regarding whether a particular dispute or controversy is . . . subject to arbitration will be decided by the arbitrator.**

The Eleventh Circuit held that this provision is an agreement to arbitrate the "gateway' question of "whether [the arbitration agreement] covers a particular controversy. The agreement to arbitrate that gateway question which the court referred to as the "delegation provision," "is simply an additional, antecedent agreement" that "is severable from the remainder of the arbitration agreement."

Under the FAA, a delegation provision is valid, "save upon such grounds as exist at law or in equity for the revocation of any contract. Courts should enforce valid delegation provisions as long as there is "clear and unmistakable" evidence that the parties manifested their intent to arbitrate a gateway question.

The terms of the delegation provision in this case provided clear and unmistakable evidence that the parties manifested their intent to arbitrate whether the account holder's claims were within the scope of the arbitration agreement where the provision read, "Any issue regarding whether a particular dispute or controversy is . . . subject to arbitration will be decided by the arbitrator." Because the delegation provision encompasses *any* issue, it encompassed the account holder's claims for relief. An arbitrator, not the district court, must decide whether those claims are within the scope of the arbitration agreement.

9 U.S.C. § 2 Validity, Irrevocability, and Enforcement of Agreements to Arbitrate.

21. Solymar Investments, Ltd. v. Banco Santander S.A., 672 F.3d 981 (11th Cir. 2012)(Dubina, C.J., Marcus, and Fay, JJ.). Personal investment holding corporations that sustained substantial losses after their money was invested in a fund managed by Bernie Madoff who perpetrated massive Ponzi scheme sued banking corporations and their officers/employees, asserting causes of action for breach of fiduciary duty, negligence, and fraud. Defendants filed a motion to dismiss pursuant to an arbitration clause of an exchange agreement executed by the parties.

The parties entered into a settlement agreement which contained an arbitration clause. The exchange agreement provided that the investors **"release[d], acquitt[ed], and forever discharge[d][defendants] of and from all past, present, and future claims . . .and any liability."** The investors, however, in a suit in the District Court of Florida contended that their understanding of the agreement was that same covered only the Madoff claims and sought to introduce parole evidence concerning the nature of the agreement.

The district court adopted the report and recommendation of a magistrate judge and granted the motion to dismiss.

The Eleventh Circuit affirmed and explained that a two-step process is required in considering the arbitrability of any contract containing an arbitration clause: (1) resolution of any formation challenges to the contract which such issues are decided by the court, i.e. fraudulent inducement, parole evidence, etc.; and (2) once the court is satisfied that the contract is binding, all other issues are left to the arbitrator.

In *Granite Rock Co. v. International Brotherhood of Teamsters*, 130 S. Ct. 2847 (2010), the Supreme Court held that issues concerning contract formation are generally reserved for the courts to decide. Such a determination is a threshold question in any dispute involving arbitration. **Therefore, the district court must first "resolve any issue that calls into question the formation or applicability of the specific arbitration clause that a party seeks to have the court enforce."** In other words, arbitration of a dispute should only be ordered where "the court is satisfied that neither the formation of the parties' arbitration agreement nor its enforceability or applicability to the dispute is in issue. Where a party contests either or both matters, the court must resolve the disagreement."

In this case, the district court properly refused to consider parole evidence in considering the nature or formation of the exchange agreement. **Where a contract is facially complete and contains no ambiguous terms, Florida law requires those contracts be enforced in accordance with their terms. Once the district court satisfied itself that the exchange agreement was a binding contract, asking the district court to further assess the validity of the exchange agreement relative to a broader, unexecuted agreement would be an invasion of the arbitrator's responsibility.**

The allegations of the amended complaint make it clear that the investors do not challenge the formation of the arbitration clause within the exchange agreement, but rather the entirety of the agreement. For example, the amended complaint states that the investors "seek a declaratory judgment declaring ‘ Exchange Agreement’ that was negotiated in connection with the parties’ initial settlement discussions . . . to be void *ab initio* because the parties never reached a final, enforceable agreement.”

28 U.S.C. § 158 Appeals.

22. DeLauro v. Porto (In re Porto), 645 F.3d 1294 (11th Cir. 2011)(Tjoflat, Carnes, and Hill, JJ.). A district court's order affirming a bankruptcy court's decision on the merits was a final, appealable order under the *Budinich* finality rule despite the existence of an unresolved issue involving attorney fees. Thus, the notice of appeal, which was filed approximately three and a half months after entry of the district court order was untimely. The facts of this case are as follows:

1. In March of 2007, Porto filed a Chapter 7 petition. Porto sought to discharge a personal injury judgment debt he had owed DeLauro since 1985.

2. DeLauro filed a complaint in the bankruptcy court containing multiple allegations of fraud, but the complaint only objected to the debtor's discharge pursuant to § 727(a)(5) which forbids discharge where "the debtor has failed to explain satisfactorily . . . any loss of assets or deficiency of assets to meet the debtor's liabilities."

3. The bankruptcy court entered judgment in favor of the debtor and awarded attorney's fees to the debtor as a sanction for DeLauro's meritless complaint.

4. On May 26, 2009, the district court affirmed the judgment on the merits but requested further briefing on the issue of whether the bankruptcy court properly granted the debtor's motion for sanctions.

5. On September 15, 2009, the district court entered an order affirming the attorney's fees sanction.

6. On October 15, 2009, DeLauro filed two separate notices of appeal of the orders dated May 26 and September 15.

As a threshold issue, the court of appeals had to determine whether it had jurisdiction over the district court's order affirming the underlying bankruptcy judgment rejecting DeLauro's objection to discharge. The jurisdictional issue turned on the timeliness of DeLauro's October 15, 2009 notice of appeal of the district court's May 26, 2009 order affirming the bankruptcy court order without deciding the attorney's fees issue.

A final order is one which ends the litigation on the merits and leaves nothing for the court to do but execute judgment. Here, the question was whether an undecided attorney's fee issue means that the litigation on the merits is not ended for final judgment purposes. In *Budinich v. Becton Dickenson & Co.*, 486 U.S. 196 (1988), the Supreme Court established a bright-line rule that the issue of attorney's fees is always collateral to the merits, and a decision on the merits, even if the attorney's fees issue remains unresolved, is immediately appealable. Under *Budinich*, the time for appeal of substantive claims starts to run from the date of the first order where the first order disposes of the party's substantive claims but not claims relating to attorney's fees. The Supreme Court explained that the bright-line rule accords with the "traditional understanding, that a decision on the merits is a 'final decision' for purposes of § 1291 whether or not there remains for adjudication a request for attorney's fees attributable to the case." *Budinich*, 486 U.S. at 202-03. Although the Eleventh Circuit has applied the *Budinich* bright-line rule to appeals from final decisions of district courts arising under 28 U.S.C. § 1291 and appeals from administrative agencies, this was the first time the court of appeals has applied the rule to a case appealed from a district court exercising appellate review of a bankruptcy decision under 28 U.S.C. § 158(a).

The Eleventh Circuit has recognized two exceptions to *Budinich* under which: (1) "a request for attorneys' fees pursuant to a contractual clause is considered a substantive issue; and an order that leaves a substantive fees issue pending cannot be 'final.'" *Brandon, Jones, Sandall, Zeide, Kohn, Chalal & Musso, P.A. v. MedPartners, Inc.,* 312 F.3d 1349, 1355 (11th Cir. 2002); and (2) that an order is not final for purposes of appellate jurisdiction where the bankruptcy court finds liability for violation of the stay, but defers assessment of damages. *In re Atlas*, 210 F.3d 1305, 1308 (11th Cir. 2000).

This case did not fall within either exception because here the unresolved issue of attorney's fees was not part of an award of damages pursuant to contract or otherwise. Here the unresolved issue of attorney's fees was, instead, part of a sanctions award issued in addition to and separate from the merits of the judgment in the case. It, therefore, fell on the *Budinich* side of the bright-line of finality. Accordingly, the Eleventh Circuit lacked jurisdiction to review the district court judgment dated May 26 which the creditor did not appeal until October 15.

The court of appeals did, however, have jurisdiction over the appeal from the district court's September 15 order affirming the award of attorney's fees as a sanction against DeLauro because that appeal was timely. The underlying bankruptcy court order noted that DeLauro's complaint cited only § 727(a)(5) as its basis for asserting that the debtor's discharge should be denied. The bankruptcy court found that DeLauro strayed far beyond the complaint during trial and in post-trial briefs raising allegations of nondischargeability under §§ 523(a)(4), 523(a)(5) and 523(a)(6), and discharge under §§ 727(a)(2) and 727(a)(4). In other words, the complaint cited the wrong code sections and the bankruptcy court declined to consider the merits of DeLauro's objections. Before the bankruptcy court denied DeLauro's objections, the debtor filed a motion for attorney's fees and costs for defending against the complaint pursuant to a Florida statute providing for an award of attorney fees where the losing party or his attorney knew or should have known that his claim lacked merit. Alternatively, the debtor sought attorney's fees as a sanction under § 105 of the Code. In the same order denying DeLauro's objection to discharge, the bankruptcy court granted the debtor's motion for attorney's fees . The only explanation given for the court's decision to sanction DeLauro was as follows:

> The Plaintiff's allegations have no factual or legal merit. He knew or should have known his Complaint has no factual or legal basis. This adversary proceeding was not brought in good faith and constitutes unreasonable, vexatious litigation.
>
> . . .
>
> The Plaintiff did not bring this action in good faith, but brought it to harass the Debtor

and delay his bankruptcy case.

The Eleventh Circuit determined that this explanation was not sufficient. "[A] conclusory finding of bad faith is not sufficient to withstand appellate review." The Eleventh Circuit has upheld a sanctions order which "contained a detailed chronology of [the creditor's] repeated failure to respond to court orders, its failure to appear before the court when ordered, and its refusal to provide discovery pursuant to the court's [order]." *See In re Sunshine Jr. Stores, Inc.,* 456 F.3d 1291, 1304-05 (11th Cir. 2006). **Here not only were the bankruptcy court's findings inadequate to support sanctions against DeLauro, but the court of appeals found that there was nothing in the record to support any finding about what DeLauro knew or did not know before his attorney filed the complaint. The mere fact that the attorney cited the wrong Code sections and failed to prove DeLauro's claims does not prove the DeLauro made his claims unreasonably, in bad faith, or to harass the debtor. Courts must "not engage in *post hoc* reasoning by concluding that, because a plaintiff did not ultimately prevail, his action must have been unreasonable or without foundation."**

15 U.S.C. § 1692g(a) Validation of Debts.

23. Clark v. Shapiro and Pickett, LLP (In re Clark), 452 Fed. Appx. 890 (11th Cir. 2012)(*not selected for publication*)(Barkett, Marcus, and Anderson, JJ.). After the debtor's third bankruptcy case was dismissed in October of 2006, Wells Fargo took steps to foreclose its rights under a note and mortgage secured by the debtor's residence. In November of 2006, the debtor sent Wells Fargo a payment which Wells returned because the payment was insufficient to bring the account current. The debtor made no further payments on the account. After Wells Fargo foreclosed, the debtor filed a lawsuit in district court against Wells Fargo and the creditor's attorneys alleging violations of the Fair Debt Collection Practices Act, wrongful foreclosure, and other counts. The district court granted summary judgment on all counts in favor of the defendants and the Eleventh Circuit affirmed.

Proof of Default: The debtor's claims hinged on whether or not her mortgage was in default at foreclosure. Wells Fargo alleged that the debtor was in default eight payments under the terms of her mortgage at the time of foreclosure. The debtor denied that she was in default at all, but such denial was totally unsubstantiated. The Eleventh Circuit found that the evidence was overwhelming that the debtor owed Wells Fargo a pre-petition arrearage when her third bankruptcy case was dismissed and it was undisputed that the debtor made no payments on the account after Wells Fargo returned the November 2006 payment. As soon as the third bankruptcy was dismissed without discharge in October of 2006, Wells Fargo took steps to exercise its rights and foreclosure sale was held on February 13, 2007.

A Chapter 13 confirmation order is given the same preclusive effect as any district court's final judgment on the merits and the confirmation order's res judicata effect prohibits the collateral attack of the plan. Here Wells Fargo timely filed a proof of claim in the debtor's bankruptcy case and no party in interest objected to same. (1) The proof of claim and the confirmation order established as a matter of law that the debtor was in default in the amount of $4,756.14 at the time she filed for bankruptcy. (2) According to the final report filed by the trustee when the debtor's bankruptcy was dismissed, the debtor still owed Wells Fargo $1,334.54 toward the pre-petition arrearage. This amount did not include post-petition arrearage, nor any post-dismissal defaults. Accordingly, the evidence was overwhelming that the debtor's mortgage was in default at the time of foreclosure.

Validation Letter: The debtor argued that the defendants violated § 1692g(a) of the FDCPA by failing to send the debtor a validation letter within five days after counsel for Wells Fargo first initiated contact with the debtor. On December 6, 2006, counsel for Wells Fargo mailed a letter addressed to the occupant of the mortgaged property pursuant to HUD regulations. On December 13, 2006, counsel sent a letter addressed to the debtor labeled "Verification Notice" which contained all of the information required by § 1692g(a). The debtor argued that counsel for Wells Fargo violated the FDCPA by sending the verification letter more than five days after the initial HUD letter.

Section 1692g(a) requires a debt collector "[w]ithin five days after the initial communication with a consumer in connection with the collection of any debt," to send written notice verifying the debt and instructing the consumer how to dispute the debt. **The Eleventh Circuit has held that a foreclosure package does not constitute an "initial communication" under the FDCPA. Because the HUD letter was a communication sent by a foreclosing party regarding a foreclosure, it was**

not an "initial communication" that triggered the five day requirement under § 1692g(a). Nothing in the foreclosure letter suggested it was an initial communication with a consumer in connection with the collection of a debt. Instead, the HUD letter informed the occupant of the property that the property was about to be foreclosed and transferred to Wells Fargo.

15 U.S.C. §1692e False or Misleading Representations.

24. Reese v. Ellis, Painter Ratterree & Adams, LLP, 2012 WL 1500108 (11th Cir. 2012)(Dubina, C.J., Carnes, and Forrester, JJ.). Borrowers filed a class action lawsuit against a law firm that represented a lender, alleging that firm's dunning letter violated the Fair Debt Collection Practices Act. In 2004, the borrowers purchased a home and property in Georgia for $650,000 with a loan from Provident Funding Associates. The borrowers signed a promissory note and executed a security deed giving Provident a mortgage on their property.

A few years later, the borrowers defaulted on the loan. In June of 2009, the law firm of Ellis, Painter, Ratterree & Adams mailed the borrowers a collection cover letter and three documents stating that the law firm represented Provident and that Provident **"demand[ed] full and immediate payment of all amounts due . . . "** The letter threatened that unless the borrowers paid all amounts due and owing under the note, attorney fees would be added to the total amount **"for which collection [was] sought."** One of the enclosed documents stated that the law firm was **"ATTEMPTING TO COLLECT A DEBT,"** and a second document stated that the firm was **"ACTING AS A DEBT COLLECTOR ATTEMPTING TO COLLECT A DEBT."** (emphasis added)

The District Court for the Northern District of Georgia dismissed the complaint for failure to state a claim. The Eleventh Circuit reversed finding that:

1. **The complaint sufficiently alleged that the letter and the enclosed documents were an attempt to collect a "debt" within the meaning of the FDCPA.** To state a plausible claim under the FDCPA, a plaintiff must allege, among other things, (1) that the defendant is a "debt collector," and (2) that the challenged conduct is related to debt collection. Borrowers' allegations that under their note they were consumers obligated to pay money to lender and that their obligation arose from a transaction involving their residence sufficiently alleged that the dunning letter and enclosed documents were an attempt to collect a "debt."

2. **The complaint sufficiently alleged that the law firm's letter and enclosures were an attempt to "collect" borrowers' debt.** The letter stated that the lender "hereby demands full and immediate payment of all amounts due." The letter also threatened to add attorney fee's to the "total amount *for which collection is sought"* unless all amounts were paid in full. And one of the documents specifically stated that the law firm "IS ATTEMPTING TO COLLECT A DEBT," and that the law firm "IS ACTING AS A DEBT COLLECTOR ATTEMPTING TO COLLECT A DEBT."

3. **The fact that the dunning letter related to the enforcement of a security interest did not prevent it from also relating to the collection of a debt within the meaning of the FDCPA.** The law firm argued that the letter and documents were not debt collection activity because the purpose was simply to inform the borrowers that Provident intended to enforce its security deed through foreclosure. That argument wrongly assumed that a communication cannot have a dual purpose. Georgia law does not require a demand for payment be included in a notice of foreclosure,

but the law firm included one anyway. The fact that the letter and documents related to the enforcement of a security interest did not prevent the documents from also relating to the collection of a debt. To rule otherwise would create a big loophole in the FDCPA. Same would allow every party demanding payment on a debt to dodge the dictates of the FDCPA by giving notice of foreclosure on the secured interest.

4. **The complaint plausibly alleged that the law firm was a "debt collector" within the meaning of the FDCPA.** Under the FDCPA a debt collector is:

> 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 to be owed or due another.

Here the borrowers alleged that the law firm was "engaged in the business of collecting debts owed to others incurred for personal, family, or household purposes," and that in the prior year the law firm had sent to more than 500 people dunning letters containing similar language to that sent to the borrowers. Thus, the borrowers plausibly alleged that the firm regularly attempted to collect debts, and thus, was a debt collector within in the meaning of the FDCPA.

Fed.R.Bankr.P. 7008 General Rules of Pleading.

25. Lubin v. Cincinnati Ins. Co. (In re Integrity Bancshares, Inc.), 2012 WL 1370845 (11th Cir. 2012)(Martin, Hill, and Ebel, JJ.). The Chapter 7 debtor, Integrity Bancshares, and its subsidiary, Integrity Bank (the "bank"), were both named insureds under a fidelity insurance bond. In November of 2007, the bank submitted a proof of loss to the insurer, Cincinnati Insurance Co., for losses sustained resulting from the fraudulent acts of certain bank employees. In August of 2008, the insurance company denied the claim. Later that month, the bank was closed and the FDIC took over as receiver. Subsequently, Integrity Bancshares filed for Chapter 7 bankruptcy.

The Chapter 7 trustee filed a suit against the insurance company seeking to recover under the fidelity bond. The FDIC intervened and argued that as Integrity Bank's receiver it had the exclusive right to pursue the breach of contract claim because it was the entity entitled to the benefit of the policy. The district court agreed and dismissed the trustee's claims. The Eleventh Circuit affirmed.

The trustee argued that the bond insured the debtor against loss regardless of which insured's employee caused the loss. The trustee pointed to a provision in the insuring agreement under which the insurance company agreed to "indemnify *the* Insured" for "[l]oss directly resulting from dishonest or fraudulent acts of an Employee committed alone or in collusion with others." The bond defined the term "dishonest and fraudulent acts" as including those that are "committed by such Employee with the manifest intent . . . to cause *the* Insured to sustain such loss." The bond further defined the term "Employee" as including "an officer or other employee of *the* Insured." (Emphasis added by the Eleventh Circuit).

The Eleventh Circuit found that the trustee's argument conflicted with the plain language of the insuring agreement. The trustee's argument does not convince us because it conflicts with the plain language of insuring Agreement A. The word "the" is used to "indicate that a following noun . . . is a unique or a particular member of its class. *Merriam -Webster's Collegiate Dictionary* 1217 (10th ed.2000). **Thus, under the Bond, an insured is covered for losses caused by its own employees, and not that of another insured. In other words, the Bond insures Bancshares against a loss caused by its own employees, and not those of the Bank. The November 2007 proof of loss contains only a claim that employees of the Bank (and not Bancshares) engaged in misconduct and that this caused the Bank (and not Bancshares) to sustain a loss.** Thus, it was the Bank, and not Bancshares, that had the right to bring the breach of contract claim premised on that proof of loss.

The court of appeals rejected an argument that this interpretation would conflict with the intention of the parties. When the plain language of an insurance contract is clear and unambiguous, the contract establishes the intentions of the parties.

Finally, the court rejected the trustee's argument that a joint insured clause in the bond gave the debtor a right of action. The clause provided that the first named insured covered by the bond "shall act for all insureds." Although the clause left open the possibility that the debtor could sue the insurer on behalf of the bank, the court of appeals held that the debtor's right under the clause to sue the insurer on behalf of the bank was not property of the estate. Under § 541(b)(1) of the Bankruptcy

Code, property of the estate does not include “any power that the debtor may exercise solely for the benefit of an entity other than the debtor.” In other words, “if property is in the debtor’s hands as agent, the property or proceeds therefrom are not treated as property of the debtor’s estate.”

Fed.R.Bankr.P. 7041 Dismissal of Adversary Proceedings.

26. Wieckiewicz v. Educ. Credit Mgmt. Corp. (In re Wieckiewicz), 443 Fed. Appx. 449 (11th Cir. 2011)(*not selected for publication)*(Hull, Pryor, and Anderson, JJ.). Bankruptcy court did not abuse its discretion by dismissing debtor's complaint with prejudice after the debtor persistently refused to comply with court orders directing him to apply for a federal loan consolidation program under which his student loan payments could have eventually been forgiven. The debtor argued that the bankruptcy court exceeded the scope of Rule 7001 by requiring him to apply for a consolidation loan during his adversary proceeding because the only purpose of an adversary proceeding is to determine the dischargeability of a debt.

Under the *Brunner* test, to establish undue hardship the debtor must prove that:

> (1) the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for himself and his dependents if forced to repay the student loan;
>
> (2) additional circumstances exist that make it likely the debtor will remain unable to pay for a significant portion of the repayment period; and
>
> (3) the debtor has made a good faith effort to repay the loans.

Here the record indicated that if the debtor qualified for a consolidation loan his payments would have been zero and the debt could have eventually been forgiven. If the debtor did not qualify for the loan consolidation, the bankruptcy court had indicated that the debtor would likely satisfy the *Brunner* test and qualify for a hardship discharge.

Although the Eleventh Circuit has held that dismissal with prejudice is a severe sanction that is to be used sparingly, "dismissal upon disregard of an order, especially where the litigant has been forewarned, generally is not an abuse of discretion." A court has authority under FED. R. CIV. P. 41(b) to dismiss an action for failure "to prosecute or to comply with these rules or a court order . . ." An order issued by a court having subject matter jurisdiction over a controversy and personal jurisdiction over the parties "must be obeyed, **regardless of the ultimate validity of the order."** Exceptions to this rule include: (1) where adequate and effective remedies do not exist for orderly review; and (2) where the order is "transparently invalid" or "patently frivolous."

Here, the bankruptcy court exercised tremendous patience by extending the debtor's deadline to apply for the loan and by repeatedly explaining to the debtor why he should apply. The defendant also offered to assist the debtor in the application process. Instead, the debtor refused to comply with the bankruptcy court's orders directing him to apply.

The debtor was not free to disregard the orders with impunity. **The debtor could have obtained review by appealing the orders to the district court rather than ignoring same.** Given "the considerable importance of [debtor's] eligibility under the Ford Program to the determination of whether he faced undue hardship under *Brunner*, the bankruptcy court certainly had nonfrivolous reasons to support the order." Accordingly, the bankruptcy court did not abuse its discretion in dismissing the debtor's complaint with prejudice.

Fed.R.Bankr.P. 7056 Summary Judgment.

27. Shuler v. Ingram & Assocs., 441 Fed. Appx. 712 (11th Cir. 2011)(*not selected for publication*)(Marcus, Wilson, and Black, JJ.). District court did not commit an error in plaintiffs' action against a debt collector and a debt collection law firm alleging violations of the Fair Debt Collection Practices Act (FDCPA) by granting summary judgment in favor of the defendants despite the plaintiffs' argument that the court failed to hold a hearing before ruling on the summary judgment motions. Nor did the court err in finding that the defendants did not violate various sections of the FDCPA.

Summary judgment is appropriate when the evidence, viewed in the light most favorable to the non-moving party, presents no genuine issue of fact and compels judgment as a matter of law. The non-moving party may not rest upon mere allegations or denials of his pleadings, but must set forth specific facts showing that there is a genuine issue for trial. Summary judgment is proper against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial.

In this case, the plaintiffs argued that the district court erred by not holding a hearing before ruling on the summary judgment motions, granting summary judgment while discovery issues remained unresolved, and failing to consider evidence in the light most favorable to the plaintiffs. The court of appeals first recognized that **it is well settled in this circuit that Rule 56(c) does not require an oral hearing.** Accordingly, the district court did not err in failing to hold a hearing.

[Editor's note - subsequent to the 2010 amendments which became effective after the entry of the underlying judgment in this case, the applicable provisions in former subsection (c) are now contained in Rule 56(a). Pursuant to the 2010 amendments, Rule 56(f)(1) also gives courts the option to enter judgment independent of the motion by granting summary judgment for a nonmovant after giving reasonable notice and a time to respond.[9]]

Nor did the district court prematurely grant the motions while discovery issues remained unresolved. **Rule 56(f) [now 56(d)] provides that if a party opposing summary judgment shows by affidavit that it cannot present facts essential to justify is position, the court may order a continuance to enable further discovery.** "Because '[c]ourts cannot read minds, . . . 'the party opposing the motion for summary judgment bears the burden of calling to the district court's attention any outstanding discovery.'"

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[9] FED. R. CIV. P. 56(f) provides:

(f) **Judgment Independent of the Motion.** After giving notice and a reasonable time to respond, the court may:

(1) grant summary judgment for a nonmovant;
(2) grant the motion on grounds not raised by a party; or
(3) consider summary judgment on its own after identifying for the parties material facts that may not be genuinely in dispute.

First, we reject the Shulers's argument that the district court procedurally erred in granting summary judgment to the defendants. For starters, because Rule 56(c) does not require an oral hearing, the district court did not procedurally err in failing to hold a hearing. Nor were the Shulers railroaded by a premature summary judgment motion. As the record shows, the Shulers initially filed suit in July 2008, the discovery period closed on October 30, 2009, and both defendants filed summary judgment motions by November 30, 2009. The Shulers never sought a continuance pursuant to Fed.R.Civ.P. 56(f), the absence of which renders the Shulers's argument meritless. Although the Shulers footnoted in their counseled oppositions to the summary judgment motions that they had ongoing discovery issues with NCO and Ingram, these issues appeared to relate only to the alleged agency relationship between the defendants, a relationship the district court treated as true anyway.

Nor did the district court fail to construe the evidence in the light most favorable to the plaintiffs. The court expressly stated on two occasions that it was construing the evidence of record in the light most favorable to the non-moving party – the plaintiffs.

12 U.S.C. §§ 5201-5261 Emergency Economic Stabilization Act.

28. Miller v. Chase Home Fin., LLC, 2012 WL 1345834 (11th Cir. 2012)(Carnes, Wilson, and Kravitch, JJ.). Miller appealed from an order of the district court dismissing his complaint for failure to state a claim. The Eleventh Circuit affirmed.

In Feburuary 2009, Miller requested a loan modification from the predecessor of Chase Home Finance. Chase agreed to temporarily modify the terms of Miller's loan, but in August 2010, Chase notified Miller that it would not extend a permanent loan modification. Miller filed suit alleging that Chase failed to comply with its obligations under the federal Home Affordable Modification Program (HAMP) by declining to issue him a permanent loan modification. The district court dismissed finding that the HAMP does not provide a private cause of action and that even if Miller's claims were independent of HAMP, they failed as a matter of law.

Congress enacted the Emergency Economic Stabilization Act of 2008 (EESA) during the 2008 economic crisis. ESSA charged the Secretary of the Treasury to act in a manner to promote home ownership. To this end, the Treasury created the HAMP which is designed to prevent avoidable home foreclosures by incentivizing loan servicers to reduce the required monthly mortgage payments for certain struggling homeowners. Servicers must abide by certain guidelines when determining a mortgagor's eligibility for a permanent loan modification. The Secretary of the Treasury designated Freddie Mac to conduct compliance assessments of HAMP participants. HAMP does not, however, expressly create a private right of action for borrowers against loan servicers.

To determine whether an implied private right of action exits, the court considered the following questions:

> (1) is the plaintiff one of the class for whose *especial* benefit the statute was enacted;
>
> (2) is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one; (3) is it consistent with the underlying purposes of the legislative scheme to imply a remedy for the plaintiff; and (4) is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law.

Applying these factors to HAMP and EESA, the court of appeals found that it is clear that no implied right of action exists. First, EESA and HAMP were designed to provide the Secretary of the Treasury with the authority and ability to restore liquidity to our financial system. Even though homeowners benefit from HAMP's incentives, HAMP and EESA were not passed for the "especial benefit" of homeowners. Second, there is no discernable legislative intent to create a private right of action. Rather, Congress gave the Secretary the right to initiate a cause of action. Third, a private right of action would contravene the purpose of HAMP (to encourage servicers to modify loans) because it would chill servicer participation based on fear of litigation. And fourth, contract and real estate law are traditionally the domain of state law.

Fed.R.Civ.P. 41Dismissal of Actions.

29. Anago Franchising, Inc. v. Shaz, LLC, 2012 WL 1380417 (11th Cir. 2012)(Wilson, Cox, and Restani, JJ.). Franchisor sued its former subfranchisor for breach of confidentiality clause of parties' settlement agreement. Following entry of stipulation for dismissal with prejudice, the district court denied the subfranchisor's motion to compel franchisor's compliance with the settlement agreement.

The court of appeals held that a stipulation of dismissal, signed by all parties who appeared, is self-executing and dismisses the case upon filing. After settlement of a case, parties may dismiss the case themselves by utilizing Fed.R.Civ.P. 41(a), which allows plaintiffs to voluntarily dismiss an action. Generally, a plaintiff may ask the court to dismiss an action at any time. *See* Fed.R.Civ.P. 41(a)(2). Under Rule 41(a)(2), the court has discretion to dismiss the case through an order and to specify the terms of that dismissal. A plaintiff may dismiss an action voluntarily without a court order in two circumstances: by filing a notice of dismissal before the opposing party serves an answer or motion for summary judgment, Fed.R.Civ.P. 41(a)(1)(A)(i), or at any time during the litigation by filing a stipulation of dismissal signed by all parties who have appeared, Fed.R.Civ.P. 41(a)(1)(A)(ii).

The stipulation filed in this case was pursuant to Rule 41(a)(1)(A)(ii). The Eleventh Circuit has previously held that notices of dismissal under Rule 41(a)(1)(A)(i) are effective upon filing, and found no reason to require judicial approval of stipulations of dismissal filed under Rule 41(a)(1)(A)(ii).

The plain language of Rule 41(a)(1)(A)(ii) requires that a stipulation filed pursuant to that subsection is self-executing and dismisses the case upon its becoming effective. The stipulation becomes effective upon filing unless it explicitly conditions its effectiveness on a subsequent occurrence. District courts need not and may not take action after the stipulation becomes effective because the stipulation dismisses the case and divests the court of jurisdiction.

After a stipulation under Rule 41(a)(1)(A)(ii) has been filed with the district court, the district court cannot retain jurisdiction by issuing a postdismissal order to that effect. For a district court to retain jurisdiction over a settlement agreement where stipulation of dismissal, signed by all parties who have appeared, has been filed, either (1) court must issue order retaining jurisdiction prior to filing of stipulation, or (2) parties must condition effectiveness of stipulation on court's entry of order retaining jurisdiction.

In this instance, the parties stipulation did not retain jurisdiction. Provision of " Stipulation for Dismissal with Prejudice" "that the Court shall reserve jurisdiction to enforce the settlement between the parties pursuant to the terms contained therein" was insufficient to retain jurisdiction, since the stipulation made no request of district court, rather, parties sought to extend jurisdiction by agreement.