

**Bench-Bar Retreat 2015**  
**Supplemental Case Law Update**  
**Judge Russ Kendig**

**Supreme Court**

**Pending Supreme Court Cases**

**Sixth Circuit Court of Appeals**

Liggett v. Schwartz (In re Schwartz), 2015 WL 4478033 (6<sup>th</sup> Cir. 2015) (unpublished)

Subject: claim amount, dischargeability

Debtor's ex-wife filed a claim in his chapter 13 case for value of her share of a liquidated IRA account awarded in their divorce, seeking treble damages and attorney fees for his alleged conversion of the account. Debtor objected to amount of claim but agreed that debt was nondischargeable. His ex-wife objected to confirmation and filed an adversary seeking nondischargeability. At same time, ex-wife sought sanctions against him in state court. Bankruptcy court allowed her claim (roughly \$60,000) but not the additional damages, rejected her § 523(a)(2), (4) and (5) claims, and confirmed the plan. District court vacated the confirmation order because Debtor was over the debt limits, dismissed the other claims as moot, and remanded.

Debtor then converted to chapter 11 and proposed to pay the claim over 60 months. His ex-wife filed a new proof of claim for \$460,000 and commenced another § 523 adversary proceeding. Debtor agreed that § 523(a)(15) prevented discharge but argued that ex-wife was precluded under res judicata from arguing a new claim amount and objected to her claim. Bankruptcy court sided with debtor and confirmed the plan. Ex-wife appealed the confirmation order, the order on her claim, and the order dismissing her adversary proceeding. District court affirmed on merits (not on res judicata).

Sixth Circuit also rejected the res judicata argument. When district court vacated the confirmation order and denied her other claims as moot, including her conversion claim, she was left without an avenue of review and could not be bound by the decision. However, Sixth Circuit upheld dismissal of the § 523 claims on the merits. Conversion requires a property interest, not merely a contractual obligation, leaving her without recourse under § 523(a)(4) and (6). As for the amount, court recognized that her methodology was plausible but that there was no proof that the bankruptcy court's methodology was clearly erroneous. Court asked for additional briefing on confirmation issue, disagreeing with Debtor's designation of his ex-wife's claim as unimpaired since she was not being compensated for the time delay the installment payments but

acknowledged that issue might be moot because parties represented ex-wife had received the full face value of her claim.

Weary v. Poteat, 2015 WL 5712191 (6<sup>th</sup> Cir. 2015) (unpublished)

Subject: § 362, contempt for violation of stay, punitive damages

Landlord sued former tenant, who then filed a bankruptcy case. With knowledge of the bankruptcy, landlord then sent letters to debtor's counsel and her mother acknowledging his inability to pursue the civil action but indicating he would be pursuing criminal charges. Debtor moved for contempt for a violation of the automatic stay. Bankruptcy court found purpose of letters was to threaten/harass debtor, found for debtor, and awarded punitive damages. Landlord appealed but did not challenge the underlying factual findings or the bankruptcy court's exercise of discretion, citing only legal error. Relying on § 362(b)(1), landlord argued that his purpose was pursuit of criminal action, which is not a violation of the stay. District court disagreed, concluding that the purpose of the letters was to coerce payment, not to further a criminal prosecution. District court also rejected his claim that result was to chill his free speech rights. Landlord appealed and Sixth Circuit upheld lower court decisions, concluding that "the communications indisputably did not advance criminal prosecution . . . and were found to be a threat whose purpose was to induce payment." Sixth Circuit also found he had not raised the First Amendment claim in the bankruptcy court and it was waived.

Mediofactoring v. McDermott (In re Connolly N. Am., LLC), 2015 WL 5515229 (6<sup>th</sup> Cir. 2015) (reporter citation not yet available)

Subject: § 503(b)(3)(D)

Three unsecured creditors successfully removed the chapter 7 trustee. When the successor trustee recovered funds as a result of the removed trustee's misdeeds, two of the unsecured creditors filed applications for administrative expenses for legal fees. In spite of recognition of the value the unsecured creditors brought to the estate, the bankruptcy court rejected the claim. District court affirmed but Sixth Circuit reversed in 2-1 decision. Although § 503(b)(3)(D) only references reimbursement to creditors in chapters 9 and 11, it is not to the exclusion of chapter 7 creditors. "[B]y using the term 'including' in the opening lines of the subsection, Congress built a mechanism into § 503(b) for bankruptcy courts to reimburse expenses not specifically mentioned in § 503(b)'s subsections." Further, nothing in § 503 excluded the requested reimbursement and equitable principles promoted the compensation.

## **Circuit Courts of Appeal – Other**

Charbono v. Sumski (In re Charbono), 790 F.3d 80 (1<sup>st</sup> Cir. 2015)

Subject: sanction v. criminal contempt

Bankruptcy judge sanctioned debtor \$100.00 for failing to deliver the trustee a copy of his request for an extension of time to file his federal income tax return pursuant to the terms of his confirmed plan. He appealed. District court upheld. He appealed again. First Circuit also upheld, finding it was within the bankruptcy court's inherent authority to sanction debtor and was not an exercise of criminal contempt. To distinguish between the two, consider "whether the issuing court made an express finding of contempt, whether the underlying conduct evinces a criminal mens rea, and whether the order falls within a recognized inherent power of the court (other than the contempt power)." *Id.* at 86. The factors here were indicative of non-criminal, inherent sanction power. All courts are imbued with this type of power in order to manage their own affairs and provide order. While bad faith may be a necessary requirement for a sanction that includes attorney fees, it is not necessary for "garden variety" sanctions. Courts have many sanction options available and should choose one that will remediate without undue hardship. Here, court took into consideration debtor's financial wherewithal, his belated compliance and lack of bad faith, the negative impact on creditors, and reduced the sanction to \$100.00, not the dismissal or \$200.00 sought by trustee.

## **Bankruptcy Appellate Panel for the Sixth Circuit**

Matteson v. Bank of Am., N.A. (In re Matteson), 535 B.R. 156 (B.A.P. 6<sup>th</sup> Cir. 2015)

Subject: failure of secured mortgage creditor to file proof of claim in chapter 13

Debtors confirmed a chapter 13 plan that included payments on two mortgages. The mortgage company did not file a proof of claim and therefore did not receive distributions. Around the time the case completed, Debtors filed an adversary to cancel the mortgage liens. Bankruptcy court found that liens survived but the balance of the mortgages should be reduced by the amounts the creditor would have received if it filed a claim. Bank appealed and BAP reversed.

Under § 1322(b)(5), long-term debts are not dischargeable. Contrary to what bankruptcy court found, there is no provision to reduce debt when payments are not made, so no basis for bankruptcy court's tactic. BAP rejected judicial estoppel suggestion, concluding that since the bank was not required to file a claim under the Code, the failure to file cannot constitute bad faith. BAP noted that the debtor or the trustee could have filed the claim for the bank. BAP also pointed out that the bankruptcy court's decision resulted in a windfall to Debtors, who received a \$9,000 refund from trustee (although the missed mortgage payments totaled more than \$30,000).

In re Aubiel, Case No. 14-8051 (B.A.P. 6<sup>th</sup> Cir. 2015)

Subject: O.R.C. § 2329.66, homestead exemption

Debtor claimed a homestead exemption in his 46' boat. The bankruptcy court sustained the objection, finding the evidence did not show Debtor used the boat as a residence and required turnover of the boat. Debtor appealed and BAP affirmed. BAP said question before court was whether Debtor's boat was his primary residence, not whether a boat can be a primary residence.

BAP found the factors used to determine domicile were helpful in its analysis. When he filed, Debtor listed the boat's dock slip as his residence and a Dennison, Ohio address for mail. Debtor admitted he did not live on the boat in the winter. Various documents, like checks, bank account statements, tax returns, and title documents for the boat failed to use boat address. His Schedule J expenses, like rent and utilities, did not correspond to amounts paid for boat dockage fees or living on a boat. His place of business was 100 miles from the boat, which happened to be named Relaxation II. Trustee carried burden of rebutting validity of exemption, leaving Debtor to demonstrate that his residential use of the boat, which he failed to do. His testimony was weak and the documentation he presented using the boat address was post-petition. There was no evidence of "if and where Debtor is registered to vote, whether he belongs to or attends any churches, clubs or unions, or if he has a doctor's office near the marina . . . location of [his] personal property, the addresses on his driver's license . . . where he files local tax returns." Trustee's objection sustained.

In re Henry, Case No. 15-8004 (B.A.P. 6<sup>th</sup> Cir. 2015)

Subject: chapter 13 dismissal order

Pro se debtor filed a chapter 13 case. Trustee objected to the plan and, at confirmation, parties agreed to deny confirmation and give the debtor an additional fourteen (14) days to file an amended plan. Although Debtor contended he mailed a plan, it never reached the docket. Case was dismissed. Debtor appealed. BAP upheld the dismissal. Standard of review is abuse of discretion and bankruptcy court's decision should be overturned only if there was clear error. Court found Debtor was aware of his obligation and the deadline to file the amended plan, so there was no clear error. Dismissal upheld.

MERV Prop., LLC v. Forcht Bancorp, Inc. (In re MERV Prop., LLC), 2015 WL 5813626 (B.A.P. 6<sup>th</sup> Cir. 2015) (reporter citation not yet available)

Subject: validity of release of claims in forbearance agreement

The debtor (MERV) was formed to purchase, renovate and run an antique mall in Kentucky. After a mortgage default, it entered into a forbearance agreement with the bank. It again defaulted and then filed a chapter 11 petition. Post-confirmation, Debtor again defaulted and the property was foreclosed. MERV then sued some of its members and the bank for breach of contract, "facilitation of fraud and theft," and equitable subordination of the bank's claim. The bank moved to dismiss, which the bankruptcy treated as a motion for summary judgment and denied. Debtor appealed.

The main issue was whether a release of claims in the forbearance agreement was enforceable. Looking at Kentucky contract law to interpret the release, the court found for bank. Debtor received consideration for the release, including dismissal of the foreclosure complaint and changes to terms of the note. The release was signed by an authorized party. The bank demonstrated its validity, shifting the burden to Debtor to show otherwise, which it failed to do. Members with 51% of the voting interests in Debtor, with apparent authority to do so, signed the

release. Even if any one of the signors had adverse interests, since Debtor benefitted from the forbearance agreement, any adverse interest exception was inapplicable. Debtor failed to present sufficient evidence to support its claim that one of the members acted fraudulently/in concert with the bank. Court found no unconscionability, pointing out that a release of claims of this nature is often executed in similar circumstances. Debtor also lost its argument that it was entitled to more discovery because it failed to act to obtain it. Debtor also failed to preserve its equitable subordination argument on appeal. Dismissal upheld.

## **Bankruptcy Courts for the Northern District of Ohio**

In re Roberts, 532 B.R. 906 (Bankr. N.D. Ohio 2015) (J. Harris)

Subject: O.R.C. § 2329.66(A)(11)

Debtor, whose children were fully grown, claimed an exemption in a \$9,000 child support arrearage owed her. Trustee objected on the grounds that the money was not being used to support a dependent and therefore the debtor was not entitled to the exemption. Debtor argued that it was necessary for her support. Court found in favor of debtor.

The burden of proof was on trustee as objecting party. Exemption statutes are to be construed in favor of the debtor. When reading a statute, a court is to read all words in reaching an interpretation, not delete words. The exemption statute says that child support is exempt “to the extent reasonably necessary for the support of the person and any of the person’s dependents.” It does not distinguish between past-due payments and current obligations or limit child support to the support of only children. Since the custodial parent provided for the child, Ohio law gives the custodial parent superior rights to child support and arrearages. The court found that the exemption protects arrearages reasonably necessary for the support of either the children or the debtor. Trustee failed to request a hearing or introduce evidence on whether the arrearage amount was reasonably necessary for support, leaving the court to rely on the schedules. Objection to exemption overruled.

In re Kirk, 2015 WL 5097741 (Bankr. N.D. Ohio 2015) (reporter citation not yet available) (J. Woods)

Subject: disbursement of ch. 13 funds by trustee following pre-confirmation dismissal

Debtors’ chapter 13 case was dismissed prior to confirmation. Trustee held approximately \$3,600 in undistributed plan payments. Debtors’ attorney requested a \$1,200 distribution for attorney’s fees from this amount. Trustee’s posited that Harris v. Viegelahn, 135 S.Ct. 1829 (2015), required return of the money to Debtor. Debtors’ attorney argued that Harris, a case that converted to chapter 7, was inapplicable and § 1326(a)(2) and § 1327 controlled. Court agreed with counsel, finding the Supreme Court’s reliance on § 348, a conversion provision, distinguished Harris. Section 1326(a)(2) specifically directs distribution of funds on hand when a chapter 13 case is dismissed before confirmation. It also provides for payment of

certain claims, including administrative expense claims, prior to a refund to debtor. In this case, the court found that counsel had a \$1,000 administrative expense claim which was to be paid before distribution to the debtor.

Botson v. Citizens Banking Co. (In re Botson), 531 B.R. 719 (Bankr. N.D. Ohio 2015) (J. Gustafson)

Subject: § 524, violation of discharge injunction, filing continuation financing statement

After receiving a discharge, Debtors filed an adversary proceeding alleging that creditor violated the discharge injunction when it filed a UCC-3 continuation statement and refused to remove a UCC-1 financing statement. In this circuit, there is no private cause of action under § 524, the remedy is found in contempt of court. To succeed, Debtors must show that a creditor knowingly violated the injunction. Debtors argued that since their after-acquired property was protected under § 552, the creditor violated the injunction. Court disagreed, finding the mere fact that a financing statement includes an after-acquired clause is not a violation as a matter of law. Since a lien passes through bankruptcy unaffected, the security interest in products and proceeds of collateral existing at the time of filing is protected. Property that is truly acquired after the petition, with no prepetition tie, is not subject to a prepetition lien. In this case, Debtors did not demonstrate, with clear and convincing evidence, that creditor's action was specifically directed at after-acquired property or an attempt to obtain payment from Debtors personally.

## **Bankruptcy Courts – Other**

In re Beaugard, 533 B.R. 826 (Bankr. D. N.M. 2015)

Subject: disposition of funds in chapter 13 upon conversion

Court addressed disposition of chapter 13 funds on hand following conversion to chapter 7. Two cases were converted before confirmation, the third after confirmation. The plans allowed trustee to disburse in accordance with plan provisions and court also considered § 1326(a)(2) which calls for payment of administrative expenses. In all three cases, court found that Supreme Court decision in Harris v. Viegelahn, 135 S.Ct. 1829 (2015), required money to be returned to the debtor(s). Conversion not only terminates the chapter 13 trustee duties, it also provides the cut-off for the binding nature of plan. Although 1326(a)(2) suggests that a trustee has the power to otherwise disburse chapter 13 funds on hand at conversion, Harris stands for the proposition that “none of the provisions of Chapter 13 apply in a case converted to Chapter 7.”

In re Carter, 533 B.R. 632 (Bankr. S.D. Ohio 2015)

Subject: special counsel, nunc pro tunc employment

During the course of her chapter 13 case, Debtor was injured in a car accident involving an uninsured motorist. She hired counsel, who obtained a settlement. Counsel then learned about the bankruptcy and emailed Debtor's attorney, who filed a motion to approve the settlement, including special counsel's compensation. The chapter 13 trustee objected to the payment of special counsel's fees because he had never been retained. Debtor then filed an application to employ special counsel nunc pro tunc. After considering eleven factors, court approved the motion, finding that the application would have been approved if timely submitted, the delay between learning of the bankruptcy and filing the application was not "unconscionable," the Debtor authorized the employment, proper notice was provided, no objections were filed, there was no prejudice to the estate, and there was no indication that the delay in filing was wrongly motivated or based on ill-intent.

Bradford v. U.S. Dep't of Treas. IRS (In re Bradford), 534 B.R. 839 (Bankr. M.D. Ga. 2015)

Subject: priority status of 10% early withdrawal penalty

IRS filed a claim in Debtors' chapter 13 case alleging that the 10% exaction fee assessed for early withdrawal of IRA funds was entitled to priority status. Debtors objected and urged the court to consider the purpose of the priority provision of the bankruptcy code in determining the nature of the exaction. The IRS argued the exaction could not be a "penalty" because there was no underlying unlawful conduct, making it a tax. Bankruptcy court agreed with Debtors, finding the penalty was not a tax and was compensation for a non-pecuniary loss, defeating priority status under § 507(a)(8)(A) or (G). Under Supreme Court precedence, the label of an exaction as a "tax" in the Tax Code is not determinative, requiring a functional analysis of the exaction. A tax is 'a pecuniary burden laid upon individuals or property for the purpose of supporting the Government.' *Id.* at 847 (citing U.S. v. Reorganized CF & I Fabricators of Utah, Inc., 518 U.S. 213, 224 (1996)). A functional analysis requires review of the purpose of the underlying statute to determine whether the exaction meets this definition. The court's review of the purpose of the priority statute led it to conclude that "exactions not enacted primarily to preserve the government fisc should not be entitled to priority." Here, the main purpose of the exaction was to "discourage spending of tax-preferred retirement funds," not support of the government. Although the exaction may compensate the government for lost taxes to some extent, support of the government is not the overriding purpose.

In re Gokay, 535 B.R. 758 (Bankr. S.D. Ohio 2015)

Subject: §2329.661(A)(4), homestead exemption, lien avoidance

Prepetition, Debtors borrowed money for their business from the Ohio Department of Development. Following default, the state obtained a judgment of approximately \$700,000. Debtors later filed a chapter 7 petition and moved under § 522(f) motion to avoid the state's lien as impairment of their homestead and wildcard exemptions. Relying on an appraisal, Debtors amended their original value of the real estate down to \$288,000. The balance on the first mortgage was \$291,666. The state argued the value was between \$307,200, the figure first

advanced by Debtors, and \$312,720, the county auditor valuation. Debtors claimed a homestead exemption of \$265,800 (\$132,900 each) and a wildcard exemption of \$20 in the property.

Ohio Revised Code § 2329.661(A)(4) is an exception to the general exemption provision and provides that “(A) Division (A)(1) of section 2329.66 of the Revised Code does not . . . (4) impair a lien for the payment of taxes, debts, or other obligations owed to this state or any agency or political subdivision of this state.” The state relied on this provision to object to avoidance. When Debtors argued that § 542 avoidance under the bankruptcy code superseded, Ohio contended it could establish its exemption laws as an opt-out state. Court sided with Debtors, finding that the Supreme Court had recognized that state exemption laws, while broad, could not conflict with the bankruptcy code. Owen v. Owen, 500 U.S. 305 (1991). Here, the bankruptcy code clearly provided for avoidance of judgment liens. Applying the numbers, courts found the lien was fully avoidable under either valuation.