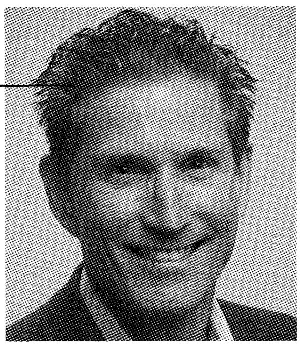
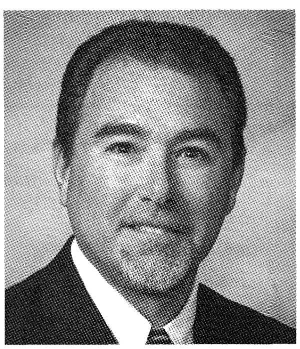
TEST YOUR KNOWLEDGE: RECENT DEVELOPMENTS IN INSOLVENCY LAW

AUTHORS



Thomas R. Phinney



Paul J. Pascuzzi

Welcome to the seventh annual edition of our article covering recent developments in bankruptcy law. This article comes from a program we present for the Bankruptcy and Commercial Law Section of the Sacramento County Bar Association. Once again, we invite you to test your knowledge of recent developments in the area of insolvency law. Unless otherwise noted, all references are to the Bankruptcy Code. We provide a summary of the facts, issues, and holdings from a mix of ten recent important and interesting bankruptcy decisions. For MCLE credit, please answer the twenty true/false questions at the end of the article. Good luck!

1. UNSCHEDULED PROPERTY IS NOT ADMINISTERED, SO NOT ABANDONED BY CLOSING OF THE CASE: *IN RE STEVENS*, 617 B.R. 328 (B.A.P. 9TH CIR. 2020)

This case involves the abandonment of property of the estate under section 554(c). Section 554(c) provides that "any property scheduled under section 521(a)(1) of this title [and] not otherwise administered at the time of the closing of a case is abandoned to the debtor."

The debtors listed a pending lawsuit against a loan servicer in their statement of financial affairs, but not on schedule A of their schedules. The debtors discussed the lawsuit with the chapter 7 trustee, including providing copies of the lawsuit to the trustee. The trustee did not attempt to administer the lawsuit during the bankruptcy case (such as by selling or compromising it). Instead, the trustee issued a no asset report stating the estate had been fully administered. Thereafter, the debtors' discharge was entered, and the case was closed.

The debtors continued to prosecute the lawsuit, but the loan servicer proposed a settlement to the trustee. The trustee reopened the bankruptcy case, settled the lawsuit, and sought court approval of the settlement. The debtors opposed the settlement on the ground that the lawsuit was abandoned when the case was first closed.

The bankruptcy court approved the settlement, finding the lawsuit had not been abandoned back to debtors upon the first closing of the case. The debtors appealed to the Ninth Circuit Bankruptcy Appellate Panel ("BAP").

On appeal the BAP affirmed. The court found that the majority rule is that the plain language of section 554(c) requires that the lawsuit have been listed on the debtors' schedules, not merely listed on the statement of financial affairs, for the lawsuit to have been abandoned by the closing of the case under section 554(c). The plain language of section 554(c) provides that an asset must be "scheduled under section 521(a)(1)" to be technically abandoned. If Congress had intended the "scheduled" assets referenced in section 554(c) to include assets listed only obliquely in the statement of financial affairs, then it could have, and should have, drafted section 554(c) to refer to assets "listed or scheduled under section 521(a)(1)."

Further, the court compared the wording in section 554(c) with the non-discharge provision in section 523(a)(3) relating to unscheduled debts. In section 523(a)(3), Congress referred to a debt "neither listed nor scheduled under section 521(a)(1)." If the court were to read "scheduled" in section 554(c) as synonymous with "listed," as the debtors argued, then "listed" in section 523(a)(3) becomes impermissibly superfluous, which is not how statutes should be interpreted. It violates the canon of statutory interpretation providing that "where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion."

The court also found that this narrow reading of section 554(c) was consistent with sound bankruptcy policies and reasonable expectations for a debtor's performance of statutory duties in that it encourages debtors to properly schedule assets, which is not an undue burden, and advances the goal of a fully transparent bankruptcy process. The court further reasoned that the narrow reading creates a bright line rule, rather than the potentially disputed issue of the trustee's knowledge outside of the filed schedules to determine whether an asset has been abandoned.

There is a minority view on this issue. Some courts have held that assets listed in the statement of financial affairs *are* "scheduled."[01]

2. PROPERTY HELD BY SPOUSES IN JOINT TENANCY IS STILL PRESUMED COMMUNITY PROPERTY: *SPEIER V. BRACE (IN RE BRACE)*, 9 CAL. 5TH 903 (CAL. 2020)

The Ninth Circuit certified a question to be answered by the California Supreme Court: what property interests are created when a married couple uses community funds to acquire real estate in California and takes title in joint tenancy, and one of the spouses later files bankruptcy? Does that property presumptively belong to the community—because the couple acquired the property during marriage with community funds—and thus become property of the bankruptcy estate of the filing spouse? Or is the property presumptively the separate property of the spouses—because they took title in joint tenancy—thus making only the filing spouse's 50% interest as a joint tenant property of the bankruptcy estate? And can the joint tenancy deed function as a "transmutation" agreement evidencing that the spouses agreed to own the property as separate property?

More precisely, the question addressed by the California Supreme Court was whether the form of title presumption set forth in Evidence Code section 662 ("The owner of the legal title to property is presumed to be the owner of the full beneficial title") applies to the characterization of property in disputes between a married couple and a bankruptcy trustee, when it conflicts with the community property presumption set forth in Family Code section 760 (property acquired during marriage is presumed to be community property).

The court analyzed a "snarl of conflicting presumptions" and changing statutes, the meaning of which have confounded courts. The facts in this case are not that uncommon: Spouses acquire real property with community funds, but take title as "husband and wife as joint tenants." One spouse later files bankruptcy, and the question arises whether the non-filing spouse has a 50% separate property interest in the real property that is not property of the bankruptcy estate, since she holds title as a joint tenant.

Most significantly, the court held that for property acquired after 1985, the community property presumption of California Family Code section 760 overrides the form of title presumption of California Evidence Code section 662, so that, in effect, the bankruptcy trustee wins, and the entire property is treated as community property that belongs to the bankruptcy estate. The analysis varies for properties acquired before 1975, and on or after January 1, 1975 but before 1985.

The full holding is best summarized by the language of the decision:

> We answer the Ninth Circuit's question as follows: Evidence Code section 662 does not apply to property acquired during marriage when it conflicts with Family Code section 760. For joint tenancy property acquired during marriage before 1975, each spouse's interest is presumptively separate in character. (Fam. Code, § 803; *Siberell*, *supra*, 214 Cal. at p. 773). For joint tenancy property acquired with community funds on or after January 1, 1975, the property is

presumptively community in character. (Fam. Code, § 760).

> If such property was acquired before 1985, the parties can show a transmutation from community property to separate property by oral or written agreement or a common understanding. (Fam. Code, § 852, subd. (e); *Estate of Blair, supra*, 199 Cal.App.3d at p. 167). Although a joint tenancy deed is insufficient to effect a transmutation, a court may consider the form of title in determining whether the parties had a common agreement or understanding under the pre-1985 rules. (See *MacDonald, supra*, 51 Cal. 3d at p. 270 & fn. 6).
>
> For joint tenancy property acquired with community funds on or after January 1, 1985, a valid transmutation from community property to separate property requires a written declaration that expressly states that the character or ownership of the property is being changed. (Fam. Code, § 852, subd. (a); *MacDonald*, at p. 272, 272 Cal.Rptr. 153, 794 P.2d 911). A joint tenancy deed, by itself, does not suffice.
>
> Nothing in our decision precludes spouses from holding separate property as joint tenants or from transmuting community property into separate property held in joint tenancy as long as the applicable transmutation requirements are met. Nor does our decision alter the operation of the right of survivorship that is the main incident of joint tenancy title.[02]

Thus, at least for property acquired by spouses as joint tenants in 1985 or later, Evidence Code section 662 (title presumption) does not apply when it conflicts with Family Code section 760 (community property presumption). The property is characterized as community property and it becomes property of the bankruptcy estate.

3. LIEN AVOIDANCE WHEN UNDERLYING CLAIM DISALLOWED: *IN RE LANE*, 959 F.3D 1226 (9TH CIR. 2020)

This case involves the question of whether a bankruptcy court may void a lien under section 506(d) when the claim relating to the lien is disallowed because the creditor who filed the proof of claim did not prove that it was the person entitled to enforce the debt the lien secures.

The debtor filed a chapter 13 case and scheduled his residence with a secured claim in favor of Bank of America, the original lender on the loan. The Bank of New York ("BONY") filed a secured proof of claim. The debtor objected to the claim, alleging that the claim failed to establish that BONY was the holder of the claim and entitled to enforce it. BONY did not respond to the claim objection, and it was sustained by the court.

The debtor performed his chapter 13 plan, received his discharge, and then filed a complaint in the bankruptcy court to avoid the BONY lien on the property under section 506(d). In pertinent part, section 506(d) provides that liens securing disallowed claims are void unless the claim is disallowed only due to the failure to file a proof of claim.

The bankruptcy court granted summary judgment in favor of the debtor and avoided the lien on the real property. BONY appealed. The BAP reversed. The BAP determined that section 506(d) does not void a lien securing a claim when a proof of claim relating to the lien is disallowed on the ground that the claim filer had not shown that it was the person entitled to enforce the promissory note associated with the lien.

The BAP noted that when a claim is disallowed on this ground, it implies that the lien secures a claim that belongs to someone else—namely, the person entitled to enforce the note. The BAP reasoned that, under these circumstances, voiding the lien would deprive the person entitled to enforce the note of due process, because that person had not been given notice and an opportunity to be heard.

The debtor appealed to the Ninth Circuit Court of Appeals. The Ninth Circuit affirmed. Subsection 506(d)(2) applies in that under the bankruptcy court's finding that BONY is not the true holder of the claim, the deed of trust "secures a claim against the debtor that is not an allowed secured claim," but "such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim." The court struggled a little bit with this; the opinion seems to convey a belief by the court that BONY was in fact the proper holder of the claim. But because the bankruptcy court found that it was not, and that finding was not appealed, Ninth Circuit had to go with that as a fact.

Section 506(d)(2) codifies the rule that a secured creditor need not file a claim in a bankruptcy case by saying that a lien securing a claim that is disallowed is void, except when the reason the claim is disallowed is because the creditor did not file a proof of claim. Under the assumption that BONY was not the real holder of the claim, the facts presented fit nicely into 506(d)(2)—the real creditor did not file a claim, so the lien securing the claim could not be avoided, because of the provisions of section 506(d)(2).

As mentioned, the court noted that, in the real world, as opposed to the hypothetical world the record created, it thought that BONY was in fact the real holder of the claim. And, if BONY could have shown it was the real holder, its claim would not have been disallowed.

4. MERE RETENTION OF ESTATE PROPERTY AFTER THE FILING OF A BANKRUPTCY PETITION DOES *NOT* VIOLATE THE AUTOMATIC STAY: *CITY OF CHICAGO V. FULTON*, 141 S. CT. 585 (2021)

This case involved four separate chapter 13 petitions. Before the bankruptcies, the City of Chicago had impounded the debtors' cars due to unpaid parking fines (between $4,000 and $20,000 each).[03] In four separate chapter 13 cases, the debtors demanded the return of their autos. The city refused to release the cars unless the fines and other charges were paid in full.

The debtors filed contempt proceedings in which four different bankruptcy judges held that the city was violating the automatic stay by refusing to return the autos. This issue has divided courts of appeal.[04] After being held in contempt, the city returned the cars but appealed.

The Seventh Circuit focused on the provisions of section 362(a)(3), which stays "any act to ... exercise control over property of the estate." In the lower courts, the debtors relied on that section, but not exclusively. The Seventh Circuit upheld the bankruptcy courts, holding "that the City violated the automatic stay . . . by retaining possession . . . after [the debtors] declared bankruptcy."

The Supreme Court reversed and remanded, holding that section 362(a)(3) prohibits affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was filed, and that mere retention of estate property after the filing of a bankruptcy petition does not violate section 362(a)(3) of the Bankruptcy Code. The decision finds a broad reading of section 362(a)(3) (1) would "largely" render section 542 (proceedings to compel turnover of estate property) "superfluous"; and (2) would make the two sections contradictory. Whereas section 542 has exceptions, section 362(a)(3) has none.

The court did not address the question of whether other statutory provisions may have been violated by the City of Chicago, including the turnover obligations of section 542; section 362(a)(4) (stay of acts to enforce lien); and section 362(a)(6) (stay of acts to collect claim).[05]

CONCURRING OPINION

In her six-page concurrence, Justice Sotomayor noted that the court had not "addressed how bankruptcy courts should go about enforcing creditors' separate obligation to 'deliver' estate property to the trustee or debtor under § 542(a)." Although Chicago's conduct may have satisfied "the letter of the Code," she said that the city's policy "hardly comports with its spirit." She went on to explain why returning a car quickly is important so a debtor can commute to work and make earnings to pay creditors under a chapter 13 plan.

The trouble with section 542, Justice Sotomayor said, is that "turnover proceedings can be quite slow," because they entail commencing an adversary proceeding. She ended her concurrence by saying that either the Advisory Committee on Rules or Congress should consider amendments "that ensure prompt resolution of debtors' requests for turnover under § 542(a), especially where debtors' vehicles are concerned."

The Supreme Court did not address sections 542, 362(a)(4) or 362(a)(6), because the Seventh Circuit did not reach those issues. Thus, debtors facing a car impound issue may still seek expedited procedures under section 542 or a favorable interpretation of section 362(a)(4) and (6).

5. ORDER DENYING RELIEF FROM THE AUTOMATIC STAY IS NOT A FINAL ORDER: *RITZEN GROUP., INC. V. JACKSON MASONRY, LLC*, 140 S. CT. 582 (2020)

This case involves whether denial of relief from stay is a final, appealable order. Ritzen Group and Jackson Masonry signed a contract for the purchase of land. The deal fell through, and Ritzen sued for breach of contract in state court. On the eve of trial, Jackson filed a chapter 11 bankruptcy case, which stayed the state court litigation pursuant to the automatic stay under section 362(a).

Ritzen moved for relief from the automatic stay, which was denied. Ritzen did not appeal that order at that time. Jackson objected to Ritzen's claim. The bankruptcy court sustained the objection after trial, finding that Ritzen breached the contract. The debtor confirmed a chapter 11 plan. Ritzen then appealed both the relief from stay denial and the claim objection.

The district court dismissed the appeal of the order denying relief from stay as untimely, since the notice of appeal was not filed within fourteen days of the entry of the order. The district court also affirmed the bankruptcy court's order sustaining the claim objection. Ritzen appealed the district court's dismissal of the appeal of the relief from stay order to the Sixth Circuit Court of Appeals.

The Sixth Circuit stated that the adjudication of Ritzen's motion for relief from stay was as a discrete "proceeding," commencing with the filing of the motion, followed by procedural steps, and culminating in a dispositive decision. The Sixth Circuit held that the denial of the motion was a disposition entered in a proceeding that finally terminated that particular proceeding. Thus, the appeal period ran from date of the order denying the motion for relief from stay.

On appeal to the United States Supreme Court, the Court, in an opinion authored by the late Justice Ginsburg, affirmed. The Court started with its analysis from *Bullard v. Blue Hills Bank*,[06] in which the Court held that an order denying confirmation of a chapter 13 plan was not a final, appealable order because it did not conclusively resolve the relevant proceeding. The relevant proceeding was the plan confirmation process, which continued even though one plan was denied approval, as the debtor would be afforded a continued opportunity to submit a revised plan for confirmation.

Here, with a stay relief motion, the bankruptcy court made a final disposition of the motion. The relevant proceeding was whether cause existed to grant relief from stay to litigate the claim in state court. That decision was made, and it was a final decision.

The creditor tried to argue that the relevant proceeding was the claims adjudication process, which was not final when the bankruptcy court decided the forum in which the claim liquidation would take place. The Court rejected that argument, because it had a narrower view—that the stay relief process was the relevant proceeding.

One question that could be raised is whether the Court's decision would have been the same if the bankruptcy court had denied the motion for relief from stay "without prejudice," which happens in bankruptcy cases. The opinion had a footnote that said, "We do not decide whether finality would attach to an order denying stay relief if the bankruptcy court enters it 'without prejudice' because further developments might change the stay calculus. Nothing in the record before us suggests that this is such an order." To the authors, it seems the situation would be different if the stay relief proceeding might be revisited later in the bankruptcy case by virtue of an order that is "without prejudice." The Court's ruling does tell us that a relief from stay proceeding is a separate, distinct proceeding, where an order likely will be a final order for purposes of appeal.

6. AVOIDANCE OF INTENTIONAL FRAUDULENT TRANSFER DOES NOT REQUIRE PROOF OF DAMAGES: *IN RE MEDINA*, 20-60045 (9TH CIR. JULY 29, 2021) (UNPUBLISHED); *STADTMUELLER V. SARKISIAN (IN RE MEDINA)*, 619 B.R. 236 (9TH CIR. B.A.P. 2020)

Fraudulent transfer claims are intended to protect creditors by "undoing" transfers of assets effected to the detriment of creditors. There are generally two broad categories of fraudulent transfer claims: transfers made with "actual intent" to hinder, delay, or defraud creditors, and transfers made by an insolvent debtor for less than reasonably equivalent consideration. In *In re Medina*, the Ninth Circuit affirmed a decision from the BAP, *Stadtmueller v. Sarkisian (In re Medina)*, that addressed a question of first impression and held that avoidance of an "intentional" fraudulent transfer does not require separate proof of damages.

In *In re Medina*, a chapter 7 trustee ("Trustee") held a money judgment against Mr. Sarkisian ("Husband"). After the Trustee attempted to enforce the money judgment, Husband entered into a transmutation agreement with his wife ("Wife") whereby their community property was divided into the separate property of Husband and Wife. Husband argued that Trustee could not enforce the judgment against Wife's (now) separately-owned property. Trustee filed an adversarial proceeding, alleging that the transmutation was voidable based upon actual fraudulent intent under California Civil Code sections 3439 to 3439.14 ("UVTA").

The bankruptcy court granted summary judgment in Husband's and Wife's favor, ruling that, while the transmutation agreement was a transfer under the UVTA, Trustee failed to prove the transfer actually injured him or the estate. Specifically, the bankruptcy court found that it appeared that Husband's assets post-transmutation were sufficient to satisfy the judgment, and the Trustee failed to show actual injury.

On appeal, the BAP reversed and remanded, holding that Civil Code section 3439.04(a)(1) does not require a creditor to prove a defined injury when alleging an actual intentionally fraudulent transfer.

On further appeal, the Ninth Circuit agreed with the BAP and held that no statutory language supports a requirement that the plaintiff prove damages or actual injury or show that the debtor's remaining assets after the transfer were insufficient to satisfy the debt without undue burden. The court held that, under section 3439.04(a)(1), the only affirmative injury required is proof that the debtor, with the intent to hinder, delay, or defraud the creditor, placed property out of the creditor's reach that could have been used to pay the debt.

One of the issues addressed in the BAP decision is that Husband relied on the California model jury instruction for actual intent fraudulent transfer claims that is included in the Judicial Council of California Advisory Committee on Civil Jury Instructions ("CACI") 4200, which suggested that damages were required. Rejecting the argument, the BAP stated that "[t]his jury instruction is not a model of clarity, but read in its entirety, it is consistent with our analysis of Mehrtash" and "[t]he jury instruction says that 'harm' is an element of the claim, but the first and last sentence show that the 'harm' to which the instruction refers is simply removing or concealing assets from creditors. That is all that is required under the UVTA." Citing to *Clem v. Lomeli*,[07] the BAP also noted that model jury instructions are not binding.

7. RETROACTIVE RELIEF FROM THE AUTOMATIC STAY IS ALLOWED: *IN RE MERRIMAN*, 616 B.R. 381 (9TH CIR. B.A.P. 2020)

This case involves whether a bankruptcy court can grant retroactive relief from the automatic stay after the United States Supreme Court decision in *Roman Catholic Archdiocese of San Juan v. Acevedo Felician.*[08]

The debtor, Merriman, filed a chapter 13 bankruptcy petition in November 2018. Creditors Ferdinand and Deann Fattorini did not receive notice of the bankruptcy case, and later filed a wrongful death lawsuit against the debtor in state court in violation of the automatic stay. The complaint was filed shortly before the state law statute of limitations expired.

Upon learning of the bankruptcy case, the Fattorinis filed a motion seeking annulment of the automatic stay retroactive to the date of the filing of the complaint. The creditors needed retroactive relief since the statute of limitations had run by then. The debtor opposed the motion.

The bankruptcy court granted the motion, annulling the stay as requested by the creditors. The court found that the Fattorinis did not have notice of the bankruptcy case before they filed the state court action. The court found that the issues in the state court action needed to be litigated and that it made sense to have those issues tried in one place. Accordingly, the court ruled that it would lift the stay retroactively to permit the Fattorinis to liquidate their damages in state court and potentially obtain findings and conclusions from the state court that could be applied preclusively in an action to challenge whether the claims were dischargeable in the bankruptcy court.

The debtor appealed the retroactive relief to the BAP. During the pendency of the appeal, the Supreme Court decided the above-referenced *Acevedo* case, in which the Court held that a United States district court's *nunc pro tunc* order remanding a removed lawsuit to state court was not effective to retroactively confer jurisdiction to validate the state court's orders entered before remand.

The BAP affirmed on the ground that section 362(d) explicitly grants the court the power to modify the stay to permit another court to exercise control over a claim, making it absolutely clear that Congress expressly gave such power, including the power retroactively to grant relief, to bankruptcy courts.

The analysis requires a short explanation of *Acevedo*. In *Acevedo*, employees of Roman Catholic academies in the Archdiocese of San Juan, Puerto Rico, sued the Archdiocese and other entities in the Puerto Rico Court of First Instance for alleged termination of pension benefits. During the litigation, the Archdiocese filed a chapter 11 case and removed the lawsuit to the United States District Court for the District of Puerto Rico. Roughly a month later, the bankruptcy court dismissed the chapter 11 case, but did not immediately remand the lawsuit to the Court of First Instance. Nevertheless, shortly after the bankruptcy case was dismissed, the Court of First Instance issued orders against various defendants requiring payments and ordering seizure of assets.

Approximately five months later, the district court entered an order remanding the lawsuit to the Court of First Instance. The order specifically provided that the remand was effective as of the date of dismissal of the bankruptcy case, thereby attempting to validate the orders of the Court of First Instance entered while the case remained in the district court. The defendants appealed the payment and seizure orders to the Puerto Rico Court of Appeals, which reversed. The Puerto Rico Supreme Court reversed the court of appeals. The U.S. Supreme Court then granted the Archdiocese's writ of certiorari.

The Supreme Court did not reach the merits of the appeal. The Court held that the Court of First Instance lacked jurisdiction to issue the payment and seizure orders at the time it did so, because the district court still had jurisdiction over the lawsuit, even though its remand order purported to be effective retroactively. This holding—that *nunc pro tunc* orders may not create jurisdiction where none exists—is consistent with other Supreme Court opinions holding that jurisdiction in the federal courts must emanate from the United States Constitution or a statute and cannot be created by the actions of a court.

Thus, the BAP in *In re Merriman* held that section 362(d), which provides the various grounds for relief from the automatic stay, does not purport to deprive the bankruptcy court of jurisdiction; rather, it explicitly grants the bankruptcy court the power to modify the stay to permit another court or entity to exercise control over an asset or claim. To the extent that jurisdiction includes a statutory grant of authority to adjudicate a matter or exercise a power, it is absolutely clear that Congress expressly gave such power, including the power to retroactively grant relief, to bankruptcy courts.

The BAP also affirmed the bankruptcy court's finding of cause to lift the stay. The bankruptcy court did not abuse its discretion in evaluating the factors for relief from stay, such as judicial economy, the expertise of the state court, prejudice to the parties, and whether exclusively bankruptcy issues are involved.

8. THE AUTOMATIC STAY DOES NOT TERMINATE AFTER 30 DAYS IN THE DEBTOR'S SECOND CASE: SECTION 362(C)(3); *IN RE DAO*, 616 B.R. 103 (BANKR. E.D. CAL. 2020)

One of the statutory changes made by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 that continues to generate divergent interpretations is section 362(c)(3), which was added in response to a perception that some debtors were abusing the bankruptcy process by filing serial cases to delay foreclosures. An inter-circuit and intra-district split of authority has arisen regarding whether the stay terminates after thirty days in the second case only "with respect to the debtor" or whether the stay also terminates with respect to property of the estate.

In this decision, the Honorable Christopher M. Klein of the Eastern District of California (the authors' home district) joined the fray and held that the plain meaning of the statute compels the conclusion that "§ 362(c)(3) does not modify or affect § 362(c)(1)"—that the automatic stay continues to protect property of the estate.

In *Dao*, a chapter 7 case was dismissed because the debtor failed to file schedules. The debtor filed a second case within a year, thus triggering section 362(c)(3), which provides in part (emphasis added):

> [I]f a single or joint case is filed by or against a debtor who is an individual in a case under chapter 7, 11, or 13, and if a single or joint case of the debtor was pending within the preceding 1-year period but was dismissed, other than a case refiled under a chapter other than chapter 7 after dismissal under section 707(b)—
>
>> (A) **the stay** under subsection (a) with respect to any action taken with respect to a debt or property securing such debt or with respect to any lease **shall terminate <u>with respect to the debtor</u>** on the 30th day after the filing of the later case.

The chapter 7 trustee promptly filed a motion asking the court to find that the automatic stay did not terminate after thirty days as to property of the estate. The requested finding would be contrary to the holding in *In re Reswick*,[09] however, which had held that, in the debtor's second bankruptcy, the stay terminated (unless extended by the court) after thirty days as to *property of the estate and* the debtor.

The court nevertheless granted the trustee's motion. The court acknowledged that the ruling did not follow *Reswick* (full termination of stay), but found that, while the reasoning of Reswick made sense in a chapter 13 case, it did not make sense in a chapter 7 case. The court concluded that a careful reading of the bankruptcy statutes indicated that the stay in a second bankruptcy case does *not* terminate after thirty days as to property of the estate.

The *Dao* decision follows what is considered to be the majority position: that property of the estate does not lose the protection of the stay in the second case.[10]

In *Dao*, the court noted that section 362(c)(1) provides that "[e]xcept as provided in subsections (d), (e), (f), and (h) of this section—(1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate." Notably absent from the list of exceptions to this rule is any reference to subsection (c)(3). Thus, "§ 362(c)(3) does not modify or affect § 362(c)(1)," and thus the stay continues to protect property until it is no longer estate property.

The court also found that the language of section 362(h) further supported this conclusion. Specifically, section 362(h) (which is a listed exception in subsection (c)(1)) provides that "the stay provided by subsection (a) is terminated with respect to personal property of the estate or of the debtor securing in whole or in part a claim, or subject to an unexpired lease, *and such personal property shall no longer be property of the estate* if the debtor fails" to timely file a statement of intention or take the action listed in such statement. (Emphasis added). Because subsection (h) (which also was added by BAPCPA) specifically provides that the stay terminates and that such property will no longer constitute property of the estate, the *Dao* decision cites this provision as strong support for the inference that Congress was aware of the distinction between the debtor and the estate and specifically chose in subsection (c)(3) not to terminate the protection of estate property.

After conducting a thorough examination of the published decisions, the court comments that "[t]he controversy has arisen predominately in chapter 13 cases" and that "[i]t is puzzling that the debaters, particularly the minority, ignore the chapter 7 implications of their chapter 13 rulings regarding § 362(c)(3). From the chapter 7 perspective, inferentially extending stay termination to property of the estate amounts to throwing the baby out with the bath water."

Until there is a Ninth Circuit or Supreme Court decision, there will continue to be a split in this circuit in interpreting section 362(c)(3) and whether the stay terminates as to property of the estate thirty days after the filing of the debtor's second case within the prescribed period.

9. NARROWLY TAILORED EXCULPATION CLAUSE DOES NOT VIOLATE BANKRUPTCY CODE: *BLIXSETH V. CREDIT SUISSE*, 961 F.3D 1074 (9TH CIR. 2020)

This case involves the validity of an exculpation clause in a chapter 11 plan. An exculpation clause releases a party participating in the bankruptcy process from liability for doing so. The Ninth Circuit is notoriously stingy in its approval of anything in a chapter 11 plan that could be considered a release of a non-debtor third party.[11]

Here, the chapter 11 plan contained an exculpation clause releasing certain non-debtors from liability for acts or omissions arising out of the chapter 11 proceedings. However, the clause did not release or exculpate any party from willful misconduct or gross negligence. Blixseth, the debtor's founder and prior owner, and a creditor in the case, objected to that clause as contrary to Ninth Circuit law prohibiting third party releases.

The bankruptcy court confirmed the chapter 11 plan over the objection. Blixseth appealed to the district court, which reversed and remanded the matter to the bankruptcy court to "explicitly identify and delineate those persons or representatives determined to be within the scope of the release parameters of Section 524(e)." (Section 524(e) says that the discharge of a debtor does not affect the liability of any other entity for that debt.)

The bankruptcy court held an evidentiary hearing and confirmed the chapter 11 plan again, with the same exculpation clause. Blixseth appealed again. The district court dismissed the appeal for lack of standing and equitable mootness. The Ninth Circuit reversed and remanded on both grounds. The district court then again dismissed the appeal because of equitable mootness. Blixseth appealed yet again.

The Ninth Circuit reversed the district court's determination that the appeal was moot, because the district court had not followed the Ninth Circuit's prior ruling that the matter was not moot. Finding that the validity of the exculpation clause was a question of law, the Ninth Circuit upheld the exculpation clause because it was narrow in scope and time and applied only to negligent conduct. The court held the exculpation clause did not violate section 524(e), which, as noted, prohibits a discharge from affecting the liability of non-discharged entities on a debt.

The court found the exculpation clause "narrow in both scope and time," noting it only released liability for acts taken during the bankruptcy, not before, so it did not affect pre-petition claims filed by creditors. The clause also applied only to negligent actions, not to willful or grossly negligent conduct, and only included parties "closely involved" in drafting the plan—primarily the largest creditor, who could have singlehandedly disrupted the confirmation process.

The court distinguished cases that had held a plan could not release non-debtors from creditor claims because this clause only applied to the "highly litigious nature of chapter 11 bankruptcy proceedings." Rather than discharging non-debtors, this exculpation clause only sought to "trim subsequent litigation over acts taken during the bankruptcy," so as to make the plan viable.

10. DEBTOR'S RIGHT TO VOLUNTARILY DISMISS A CHAPTER 13 CASE UNDER SECTION 1307(B) IS ABSOLUTE: *NICHOLS v. MARANA STOCKYARD & LIVESTOCK MARKET (IN RE NICHOLS)*, NO. 20-60043 (9TH CIR. SEP. 1, 2021)

Concluding that *Law v. Siegel*[12] implicitly overruled its own precedent, the Ninth Circuit held that a bankruptcy court must dismiss a chapter 13 case on motion by the debtor under section 1307(b), regardless of "bad faith" allegations. The Sixth Circuit recently reached the same result.[13]

Husband and wife debtors filed a chapter 13 petition. Shortly after that, they were indicted in federal court for fraud. To avoid potential self-incrimination and undermining their defense of the criminal case, the debtors refused to testify at a meeting of creditors, did not file tax returns, and did not propose a plan.

The creditor, who was the victim of the alleged criminal fraud, filed a motion to convert the case to chapter 7 under section 1307(c). The bankruptcy court indicated it would grant the motion under section 1307(c) (for "cause") and (e) (failure to file tax returns), but also gave the debtors thirty days to comply with their chapter 13 obligations. Before the thirty days ran out, the debtors filed a motion for voluntary dismissal under section 1307(b), which provides that "[o]n request of the debtor at any time, . . . the court shall dismiss a case under this chapter."

The bankruptcy court denied the motion to dismiss, relying on *In re Rosson*,[14] and granted the motion to convert the case to chapter 7. The BAP affirmed the bankruptcy court.

The Ninth Circuit reversed and remanded, holding that section 1307(c) does not allow for any bad faith exception, and that its *Rosson* precedent, which held otherwise, was impliedly overruled by *Law v. Siegel*.[15]

LAW OVERRULES *ROSSON*

In *Rosson*,[16] the debtor had been directed to deposit proceeds from an arbitration award with the chapter 13 trustee. When the debtor failed to make the deposit, the bankruptcy court indicated it was converting the case to chapter 7 *sua sponte*. Before the bankruptcy court could convert, the debtor filed a motion to dismiss under section 1307(b). The bankruptcy court denied the motion to dismiss and converted the case. The Ninth Circuit upheld a "bad faith" exception to the debtor's right to dismiss a chapter 13 petition, based upon *Marrama v. Citizens Bank of Massachusetts*,[17] which in turn had held that the debtor's right to convert from chapter 7 to chapter 13 pursuant to 11 U.S.C. § 706(a) ("the debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time") was subject to the requirement that a debtor must be acting in good faith to be eligible to be a chapter 13 debtor. In *Rosson*, the Ninth Circuit "understood *Marrama* to stand for the broad proposition that even otherwise unqualified rights in the debtor are subject to limitation by the bankruptcy court's power under § 105(a) to police bad faith and abuse of process."[18]

Six years later, the Supreme Court issued its *Law* decision. The Ninth Circuit, in the *Nichols* decision, paraphrased the case as holding "that a bankruptcy court may not use its equitable powers under § 105(a) to contravene express provisions of the Bankruptcy Code." The *Nichols* court found that "*Rosson* has been effectively overruled by *Law*," *and that* "§1307(b)'s text plainly requires the bankruptcy court to dismiss the case upon the debtor's request. There is no textual indication that the bankruptcy court has any discretion whatsoever."

The court found that the "absolute right" to dismiss was entirely consistent with the policy of section 303(a), designed to make chapter 13 a voluntary alternative to chapter 7. The decision ended by suggesting that although dismissal is mandatory, there are other remedies for a debtor's misconduct. "We are confident that the Bankruptcy Code provides ample alternative tools for bankruptcy courts to address debtor misconduct." The court left unaddressed, however, what those alternative tools might be.

**Thomas R. Phinney is a partner with Parkinson Phinney in Sacramento practicing bankruptcy law and commercial litigation. Mr. Phinney is a Business Bankruptcy Specialist certified by the American Board of Certification. Mr. Phinney is a member of the Government Affairs Committee of the California Lawyers Association, and former Chair of the Insolvency Law Committee. www.parkinsonphinney.com*

**Paul J. Pascuzzi is the Managing Partner at Felderstein Fitzgerald Willoughby Pascuzzi & Rios LLP in Sacramento. Mr. Pascuzzi is a former chair of the Business Law Section Executive Committee and the Insolvency Law Committee. Mr. Pascuzzi's practice focuses on all aspects of business bankruptcy and insolvency law. www.ffwplaw.com*

01 *See, e.g.*, United States *ex. rel.* Fortenberry v. Holloway Grp., Inc., 515 B.R. 827, 829 (W.D. Okla. 2014); West v. Jeppesen (*In re* Krachun), No. 15-2016, 2015 WL 4910241, at *6 (Bankr. D. Utah Aug. 14, 2015); *In re* Hill, 195 B.R. 147, 150-51 (Bankr. D.N.M. 1996).

02 Speier v. Brace (*In re* Brace), 9 Cal. 5th 903, 938-39 (Cal. 2020).

03 In 2018, parking and traffic ticket revenues for the City of Chicago were about $272 million, or approximately 7% of city revenues. In 2019, the City of Chicago overhauled its parking ticket collection system to make it less punitive.

04 The Second, Seventh, Eighth, Ninth, and Eleventh Circuits have imposed an affirmative duty on creditors to turn over repossessed property after a bankruptcy filing. The Third, Tenth, and District of Columbia Circuits have held that the retention of property only maintains the status quo.

05 On remand, the bankruptcy court determined that further proceedings were moot. *In re* Fulton, No. 18-2527 (7th Cir. Apr. 12, 2021), (ILNB Case 18-02860, doc. 135).

06 Bullard v. Blue Hills Bank, 575 U.S. 496, 501 (2015).

07 Clem v. Lomeli, 566 F.3d 1177, 1181 n.2 (9th Cir. 2009).

08 San Juan v. Acevedo Felician, 589 U.S. ___, 140 S. Ct. 696 (2020).

09 *In re* Reswick, 446 B.R. 362 (9th Cir. B.A.P. 2011).

10 *See* Rose v. Select Portfolio Serv'g, Inc., 945 F.3d 226 (5th Cir. 2019), *cert. denied*, No. 19-1035 (June 29, 2020) ; Rinard v. Positive Invs., Inc. (*In re* Rinard), 451 B.R. 12, 19-20 (Bankr. C.D. Cal. 2011, J. Clarkson). The "minority position" is that the stay also terminates as to estate property. *See* Smith v. Me. Bureau of Revenue Servs. (*In re* Smith), 910 F.3d 576 (1st Cir. 2018).

11 *See, e.g.*, *In re* Am. Hardwoods, Inc., 885 F.2d 621, 626 (9th Cir. 1989); *In re* Lowenschuss, 67 F.3d 1394, 1401 (9th Cir. 1995).

12 Law v. Siegel, 571 U.S. 415 (2014).

13 *See* Smith v. U.S. Bank N.A. (*In re* Smith), No. 20-3150, 2021 BL 318517 (6th Cir. June 9, 2021).

14 In re Rosson, 545 F.3d 764 (9th Cir. 2008).

15 *Law*, 571 U.S. 415 (debtor's exemption cannot be surcharged for expenses caused by the debtor's bad faith conduct, because the statutory language granting the debtor exemption rights was unqualified).

16 *Rosson*, 545 F.3d 764.

17 Marrama v. Citizens Bank of Mass., 549 U.S. 365 (2007).

18 *Rosson*, 545 F.3d at 773 n.12.