WESTERN DISTRICT OF VIRGINIA EIGHTH ANNUAL BANKRUPTCY CONFERENCE RECENT DEVELOPMENTS IN CHAPTER 13 & GENERAL BANKRUPTCY CASE LAW JUNE 10, 2022

<u>I.</u> <u>IMPORTANT CASES: WESTERN DISTRICT BANKRUPTCY AND DISTRICT COURTS</u>

<u>1.</u> **<u>Harlow v. Wells Fargo & Co.</u>**, 5:20-cv-00046, (Dist. Ct. W.D. Va. 3/9/21) (Urbanski)
Reference of the Adversary Proceeding is withdrawn; mandatory vs. permissive withdrawal; litigation with Wells Fargo over its filing of forbearance notices in Chapter 13

The District Court granted Wells Fargo's motion to withdraw the reference of the adversary proceeding to the Bankruptcy Court and consolidate the withdrawn case with *Forsburg v. Wells Fargo*. ""Because 28 U.S.C. § 157(d) requires the court to withdraw the reference under these circumstances and because the factors for discretionary withdrawal weigh in Wells Fargo's favor, the court will GRANT Wells Fargo's motion to withdraw the reference and consolidate this case with the *Forsburg* litigation." The litigation arose from Wells Fargo's practice of placing chapter 13 debtor mortgages into forbearance in response to the COVID-19 pandemic. Harlow filed the adversary alleging that "Wells Fargo unilaterallfbecky filed false mortgage forbearance notices in bankruptcy courts across the country without their consent, which place Chapter 13 debtors at risk of having their bankruptcy cases dismissed or denied due to over- or under-payment of their mortgage obligations." The Court provided an extensive discussion of mandatory and permissive withdrawal and the various factors to be considered. "In sum, the court finds that the combination of core and non-core claims and the uniform administration of bankruptcy proceedings do not weigh in favor of either party, and its prerogative to reduce forum shopping and the plaintiffs' other concerns are outweighed by the promotion of judicial economy, efficient use of the parties' resources, and the preservation of Wells Fargo's right to a jury trial."

<u>Held</u>: The court granted Wells Fargo's motion to withdraw the reference of this adversary proceeding to the bankruptcy court and to consolidate it with the *Forsburg* litigation.

<u>2.</u> **<u>In re Taylor</u>**, 09-72532 (Bankr. W.D. Va. 7/21/21) (Black)
Court denies pro se debtors' motion to hold creditor in contempt for violating the discharge order.

This matter came before the Court on the motion of Herbert Sherman Taylor and Lillian Marie Taylor (the 'Taylors'), appearing pro se, to hold Signature Properties of Roanoke, LLC ('Signature'), its principal, and its attorney in violation of the discharge injunction of 11 U.S.C. § 524(a).

<u>Held:</u> "The Property was scheduled as an asset of the Taylors and was not otherwise administered at the time of closing the bankruptcy estate. It was deemed abandoned to the Taylors when the case was closed. 11 U.S.C. § 554(c). The stay was lifted by consent prior to discharge. There is no asset to be administered, and there is no violation of the discharge injunction. There is no relief that can be granted by this Court."

<u>3.</u> **<u>Tranco Farms, Inc.</u>**, 21-50117 (Bankr. W.D. Va. 8/13/21) (Connelly).
[Chapter 12] Detailed Confirmation Order confirming a complex Chapter 12 plan.

This Chapter 12 plan was funded by sale of equipment and real estate and crop sale proceeds. Among other things, the Court deleted interest to be paid to the IRS on its priority claim; allowed a secured creditor to be paid from the proceeds of sale from real estate on which it did not have a lien; required motions and notice to obtain Court approval for subsequent sales of equipment and real estate, which motions would need to specify liens and their priority, amounts owed, proposed disbursement of proceeds, and the escrowing of capital gain taxes; required the filing by the Debtor of monthly operating reports and bank statements throughout the five years of the Plan; and held that payments on the priority and general unsecured claims were to be made by the Trustee.

Held: The plan was confirmed with special provisions.

4. **In re Joseph Ascue**, 93-01085 and 97-03313 (Bankr. W. D. Va. 8/17/21) (Black).
[**Chapter 7] Debtor's motion to overturn a 20-year old determination of non-dischargeability of his medical school student loan is denied.**

Debtor filed a pro se motion alleging violation of the discharge injunction by the Unites States Public Health Scholarship Program, and the Court reopened the Debtor's two prior case. The U.S. Attorney filed a response, and the matter was briefed and argued. Facts: The Debtor attended Eastern Virginia Medical School and graduated in 1984. He signed a contract with the National Health Service Corps ("NHSC") and received a total of $42,000 in scholarship awards. He was required to provide one year of service for each year he received financial support; failure to complete the service would entitle the US to recover liquidated damages of three times the scholarship funds awarded, plus interest. The Debtor filed Chapter 7 case in 1988, listed $300,000 owed to NHSC for "medical school," and received his discharge. In 1994 the US filed suit against the Debtor in District Court for $333,000; the Court found that the Debtor had breached his contract and the debt was not discharged in the prior case. The Debtor filed Chapter 7 again in 1997, at which time the debt had grown to over $500,000. In a complaint to determine dischargeability, the Court cited the Debtor's health, limited earning power, and refusal to make payments and entered judgment for $126,051, which was the trebled amount of the original debt, and discharged the balance. The Bankruptcy Court's decision was affirmed by the District Court. Since 2005 the US has collected $45,651 from tax intercepts, but the debt has grown to $134,731. The Bureau of Health Workforce ("BHW") denied the Debtor's request for waiver, because he had monthly income of $6,056 and owned property worth $476,000. Debtor argues that he is a 100% disabled veteran, he can't work, and the debt should be discharged because the government has recovered $50,000, more than the original debt.

Held: (1) Since the District Court twenty years ago affirmed the non-dischargeability of the debt, res judicata precludes the re-litigation of those issues. (2) Since the debt is non-dischargeable, the US' collection efforts did not violate the discharge injunction. (3) The initial contract with NHSC provided that a waiver "may be granted" in cases of extreme hardship, so it was discretionary, not mandatory. If the Debtor wishes to contest that determination, it is not an issue that arises under Title 11, and is not within the jurisdiction of this Court. (4) The Debtor's motion is denied.

5. **Bell v. U.S. Dep't of Educ. (In re Bell),** 633 B.R. 164 (Bankr. W.D. Va. 2021) (Connelly).
(Chap. 7 case) Applying the *Brunner* test, the Court discharges the debtor's student loans.

Pro se Chapter 7 Debtor filed a complaint to discharge his student loans under Code sec. 523(a)(8).
Facts: Debtor incurred multiple student loans during 2011-2014 at for-profit Strayer University as he sought a Master of Public Administration. Two of the ten loans were paid in full; seven are still outstanding. The repayment period on the loans was originally ten years; the interest rate ranged from 5.41% to 6.80%. As of 12/20, the balance was $109,984, of which $24,711 was current interest and $10,893 was capitalized interest. Debtor was 67 years old at case filing; his income from driving a limo plummeted when the pandemic hit, so he worked as a substitute school teacher while looking for full-time employment. He earned a Masters degree from the University of Maryland, which education expense has been paid in full. While working at the DC Dept. of Motor Vehicles, he tried to obtain a federal government job, and enrolled at Strayer to better his chances for such employment. He did obtain two

positions with the government, and he moved from D.C. to Winchester to work for FEMA, but he was terminated from FEMA in 3/19. When the loans became due in 2015, because of his low income he was approved for a general forbearance from 4/15 to 5/19. Beginning in 5/19 he was placed in an Income Drive Repayment ("IDR") plan with a monthly payment of $0/mo. through 5/21.

Analysis: (1) "In attempting to apply the undue hardship language, courts have strayed from a natural reading of the statute to develop judicial tests." (2) There are two basic tests: the *Brunner test (2nd Cir., 1983),* and the "totality of the circumstances" test adopted by the 8th Cir. and the 1st Cir. BAP (*Long* and *Bronson).* The former requires an inability to maintain a "minimal" standard of living for the debtor and her dependents; such circumstances will persist during the repayment period; and the debtor has made good faith efforts to repay the loan. The latter requires only an inability to maintain the minimal standard of living. In the former, the test factors are mandatory; in the latter, "appropriate relevant factors are weighed and no one factor is determinative." (3) Since the 4th Cir. adopted the *Brunner* test (*Frushour)*, this Court will apply that test. (4) [The Court reviewed the history of Code sec 523(a)(8): its 1978 introduction; the 1979 amendments; the *Brunner* decision for a debtor who was seeking undue hardship a year after graduation; the 1990 amendments; the 1998 amendments; and the 2005 amendments]; (5) Undue hardship" is not defined in the Code, but sec. 524(m)(1) provides a presumption for it; it compares income-less-expenses to the monthly payment required to reaffirm a debt. This provision was not considered by the 4th Cir. in *Frushour* or *Spence* because those cases predated its enactment. (6) This Court finds sec. 524(m)(1) is "informative" in interpreting sec. 523(a)(8), which, like sec, 524, "compel a bankruptcy court to evaluate the facts and circumstances of each debtor's financial situation, and specifically whether the debtor has the ability to repay that particular debt…"(7) Using the standard of sec. 524 (m)(1), a presumption of undue hardship would arise for this debtor, but because of stare decisis, this Court will apply the *Brunner* test to Mr. Bell. (8) Mr. Bell satisfies the "minimal standard of living" prong of the test. (9) Prong two—this state of affairs will persist for a significant portion of the repayment period—under *Frushour* requires a "certainty of hopelessness" re the debtor's ability to repay the loan during the repayment period. The Court will examine the debtor's employment history, education, licenses, current income, and efforts to find a higher paying job. (9) Income in the range available to Mr. Bell is not sufficient to pay the debt during the remainder of the repayment period, much less to pay that and maintain a minimum standard of living, and is not likely to improve during that period. (10) If Mr. Bell stays in the IBRP, currently $0/mo., he may qualify for forgiveness of the balance of his loans, but he will face tax liability on the amount of the forgiven loan; he would not face this if the debt is discharged in bankruptcy. (11) The Court rejects the DOJ's argument that anyone who qualifies for an IBRP cannot satisfy the second prong; it would render sec. 523(a)(8) "meaningless": *no payment* does not constitute repayment. (12) Participation by Mr. Bell in an IBRP program into his late eighties imposes hardships regardless of the payment amount. (13) The Court finds that Mr. Bell has satisfied the second prong; his participation in an IBRP is an indicator of his good faith. (14) Prong three—a good faith effort to repay the loans: Mr. Bell has not made any payments on the loans since graduating from Strayer, but he has stayed in touch with DOE, continued to look for employment, and pursed DOE options and forbearances. DOE cannot argue lack of good faith when it allowed him to enter into these programs. He made no payments because his financial situation rendered him unable to do so. He made good faith efforts to repay these loans, so prong three is satisfied. (15) These student loans will be discharged.

Held: "Section 523(a)(8) does not outright forbid the discharge of student loans; it excepts from discharge student loans the repayment of which would not impose an "undue hardship" on the debtor.

Mr. Bell has shown this Court that he has met the three prongs of the Brunner test to show that repayment of the student loan debt would impose an undue hardship on him. Mr. Bell has shown this Court that facts and circumstances prevent him from repaying the student loans in question while still maintaining a minimal standard of living, even when aided by a discharge of other prepetition debts. Mr. Bell has shown that his current circumstances are likely to persist during a significant portion of the repayment period and that he has made a good faith effort to repay the loan. In all, Mr. Bell has proven repayment of his student loans would impose an undue hardship on him. For these reasons, this Court will enter an order granting his Complaint and discharging his student loans."

6. **<u>In re Trevor and Sarah Ross</u>**, 20-50885 (Bankr. W.D. Va. 11/22/21) (Connelly).
Chap. 7 case. **Debtor can exempt farm equipment under Virginia Code Section 34-26(7) if farming is an occupation of hers, even if it is not her *primary* occupation.**

The case was filed as a Chapter 13, then converted to Chapter 7. The two debtors exempted a total of $20,000 ($10,000 each) in five items of farm equipment under VaC 34-26(7). The Trustee objected to the exemptions, claiming that farming was not the Debtors' primary or principal trade or occupation. Husband is a farmer; wife is a farmer *and* a school principal. They own jointly the farm and the farm equipment in question. The equipment was purchased with funds from their joint account; most of the funds in this account came from the wife's income as a school principal. (1) The statute does not define "occupation" or "trade." Items can be exempted if they "are necessary for use in the course of the householder's occupation or trade." (2) The Virginia Supreme Court has not decided whether this exemption is limited to a debtor's primary or principal occupation. (3) The statute does not include any words that would so restrict the exemption. (4) Because the husband is a farmer, he is entitled to claim an exemption in the farm equipment. (4) The Trustee points to 3 E.D. of VA cases to support his objection. The *Samuel* opinion (1984) held only that the debtor was not a fisherman and was thus not entitled to exempt a workboat. The *Allen* decision (1985) held that a carpenter could be a "mechanic" for purposes of the statute, and he could therefore exempt his tools. In both cases, the wording of the statute was at that time more restrictive than its current wording ("mechanic, fisherman, or oysterman" vs. "occupation or trade"). In *Cordova* (2008), Judge Mitchell held that a debtor cannot have more than one trade or occupation for purposes of this statute, but he didn't "rule out the possibility that a unique set of facts might exist that would justify a finding of finding multiple occupations for a particular debtor." (5) This Court finds the reasoning in the first two cases to be "unpersuasive and inapplicable" to the different language in the current statute, and is "disinclined to read any additional words or limitations" into the current statute. It declines to follow these three cases. (6) The wife is a farmer and this equipment is necessary for that occupation, so she is eligible to claim this exemption.

<u>Held:</u> "Section 34-26(7) of the Virginia Code permits a debtor to claim an exemption in "[t]ools, books, instruments, implements, equipment, and machines, . . . which are necessary for use in the course of the householder's occupation or trade not exceeding $10, 000 in value." It is uncontested that Mrs. Ross is a farmer. It is uncontested that the farm equipment in which she has claimed an exemption is "necessary for use in the course of" her trade or occupation as a farmer. It is uncontested that the value she has claimed as exempt does not exceed the statutory limit of $10, 000. Based on the uncontested facts and the language of the statute, this Court concludes Mrs. Ross is eligible to claim the exemption under Virginia Code section 34-26(7). Accordingly, the Court overrules the Trustee's objection."

7. **<u>In re Service Dogs by Warren Retrievers, Inc.,</u>** 20-60860 (Bankr. W.D. Va. 1/12/22) (Connelly)
(Chapter 7) Payments made by prospective buyers of service dogs to a fraudulent organization are "claims" to be paid by the Trustee; donations from third parties toward the purchase price are not.

<u>Background:</u> Each person who wished to obtain a service dog from the debtor, which held itself out as a charitable organization, entered into a "Pledge and Training Agreement" for $25,000 per dog. The buyers could seek financial help from third party donors if needed. Many buyers who paid the purchase price did not receive a dog, or received a dog that was not properly trained. As a result, the Commonwealth of Virginia filed a state court action under the Va. Consumer Protection Act (the "VCPA") against the debtor and its principal, Charles D. Warren, Jr. While that action was pending, the debtor signed more contracts, and disposed of assets, failed to deliver dogs, and filed this case. The debtor in this case listed 180 individuals with executory contracts for the purchase of dogs. The Commonwealth sought and obtained relief from the automatic stay, and obtained a default judgment in state court which found misrepresentations, willful violations of the VCPA, and significant losses by many of the buyers. It awarded the Commonwealth judgment for $357,461 for restitution to those who had suffered the losses; $1,175,816 to be held in escrow for the charitable organizations that had helped raised funds for the dogs; and

$805,000 for various civil penalties; and $268,908 for attorney fees. The Attorney General established a process (the "AG's process") for individuals to file a restitution claim.

<u>The objection:</u> The Trustee filed an omnibus objection to disallow 107 buyer and fundraiser claims on the grounds that they do not qualify as "claims" under the Code, or, in the alternative, they are properly accounted for in the AG's process.

<u>Analysis</u>: (1) The definition of "claim" in Code sec. 502(a) is expansive in its purpose, and includes all legal obligations of the debtor. (2) The Trustee argues that the payments made to the debtor were all charitable contributions, and therefore gifts, because, among other thing, they qualified for a tax deduction and there were no refunds. The claimants believe their claims are for breach of contract. (3) The admittedly not-well-drafted contract has language that demonstrates that these payments were not gifts, including the creation of a security interest if the dog is paid for in installments, warranties, and default and cure provisions. But it also has some provisions that indicate that payments being made donors are gifts. The debtor listed these obligations as executory *contracts*, and 77 of them filed claims. (4) There is no evidence that the buyers made these payments without the expectation of receiving a dog. (5) Under the Code sec. 101(5) definition of "claim," the question is whether the buyers had a right to payment under non-bankruptcy law as of the petition date, not whether they would have prevailed. They did have such a right. (6) Court does not need to determine if the buyer has a claim based on amounts paid to the debtors by third parties on the buyer's behalf; that question is not before the Court. (7) The Trustee argues that when the buyers have a right to seek payment through the AG's process, they should not be allowed to also participate in the bankruptcy process, even though under each of these processes the buyers will not be paid in full; these claims should be denied on equitable grounds. The Trustee has not provided the Court with a statutory basis other than sec. 105 to disallow these claims based on the grounds of administrative burden, so this argument must fail. (8) The Court agrees with the Trustee that the 14 donor claims that don't qualify for restitution damages under the AG's process can be objected to because they have no independent claim against the debtor, no contract with the debtor. (9)

<u>Held:</u> Certain of the Trustees objections to claim are overruled, and others are sustained.

<u>8.</u> **<u>In re James Evans</u>**, 21-50075 (Bankr. W.D. Va. 2/4/22) (Connelly).
Debtor's ex-wife violated the automatic stay by seeking to hold him in contempt in the state court; Debtor's actual damages will be awarded.

Debtor moved the Court to award damages against his ex-wife for violation of the automatic stay. <u>*Facts:*</u> The ex-wife filed a claim for $114,500 arising out of a property settlement and separation agreement ("the PSA") with the Debtor. The Debtor was to have paid her $135,000 within 30 days of the 9/12/20 agreement, and then $1,000/mo. for 77.5 months beginning 10/15/20. Despite the fact that nothing in the claim showed that any amounts due were for support, she classified the entire claim as a priority debt. The Debtor paid $99,000 of the debt to her in the three months before this case was filed, and scheduled the $1,000/mo. payments as an ongoing monthly expense. The proposed plan was confirmed on 6/1/21. By its terms, the Debtor would pay Ms. Evans $1,000/mo. during the plan and any balance of the $114,500 owing at the end of the case would survive the Chapter 13 discharge. On 6/10/21 Ms. Evans filed in the state court an action to hold the Debtor in contempt for failing to comply with the PSA, to enforce the property settlement, and to compel the Debtor to pay a foreclosure deficiency (even though the debt was being paid in full in the plan). At an 8/16/21 hearing the state court found the Debtor in contempt and ordered him to provide certain documentation, perform certain tasks, and make certain payments using funds from his retirement account which had been exempted from his bankruptcy estate; it took under advisement a potential jail term and set additional hearings. The Debtor complied with the ordered tasks except for proving that the bank had released the ex-wife from liability on the foreclosure arrearage. On 10/29/21 the Debtor filed a motion in this Court to hold Ms. Evans in contempt for violating the automatic stay in filing the state court motion; the state court allowed her to withdraw her contempt motion there but ordered the Debtor to pay $3,117 for her attorney's fees.

Held: (1) Code sec. 362(b)(2)(B) excepts from the automatic stay collection of a DSO from property that is not property of the estate. Ms. Evans argues that "collection" includes the commencement of actions. (2) Sec. 362(b)(2)(A)(ii) provides for such an exception to establish or modify an order for a DSO, but contempt actions go beyond this and violate the stay, and a creditor must first seek relief from the automatic stay in Bankruptcy Court. (3) Her state court action was against the Debtor's person, not just against property that was not property of the estate. So her actions do not fall within any of the exceptions in sec. 362(b). (4) Sec. 362(k)(1) provides for actual damages if the violation of the stay was "willful," which means that the party knew of the bankruptcy filing; a creditor does not need to act with the specific intent to violate the stay. (5) Here, Ms. Evans knew of the bankruptcy case, sought legal advice, and chose not to seek relief from the stay. So her violations were willful. (6) The Debtor's actual damages in this instance include all amounts paid to his bankruptcy attorney and to her attorney in the state court action. (7) Punitive damages are reserved for cases of "egregious and intentional misconduct," and are not appropriate in this instance. (8) A hearing will be held on 3/10/22 to determine the amount of actual damages.

Held: "The Court finds that Yvonne Evans committed willful violations of the automatic stay. Because Mr. Evans was injured by the violations, the Court finds that Mr. Evans is entitled to recover actual damages pursuant to section 362(k)." The Court set a hearing on damages.

4/20/22: Order Denying Motion to Reconsider: Ex-wife filed a motion asking the Court to reconsider its finding that she had violated the automatic stay.

Held: (1) Court will treat this motion to reconsider as a request under Rule 9023; (2) FRCP 59(e) as interpreted by the Fourth Circuit allows for three grounds to amend a judgment: an intervening change in controlling law, new evidence not available at trial, or correcting a clear error of law or preventing manifest injustice; (3) Only grounds cited by the ex-wife is the correct meaning of "collection" in sec. 362(b)(2)(B); (4) This Court adopted a narrow interpretation of this term, and in reaching this conclusion did not rely upon an outdated version of *Collier on Bankruptcy* as alleged by the ex-wife; (5) "Collection" is not synonymous with "enforcement," and while the latter term was used in other parts of sec. 362 it was "notably omitted" from 362(b)(2)(B), so Congress's failure to use the broader term there was likely intentional; (6) Congress would not have needed to create seven subsections of sec. 362(b)(2) itemizing specific domestic support actions that are excepted from the automatic stay, or specified an exception from non-estate property, if the term were intended to be as broad as the ex-wife alleges; (7) Seeking incarceration is not just a means of "collection"; (8) A creditor should ask this Court for relief from the stay before taking an action against the Debtor's person; (9) The Debtor had not defaulted in the payment of this DSO under this plan, and the entire balance was not accelerated by the filing of this case; (10) This Court will not use Rule 9023 to find that the deficiency debt owed to the Bank of the James is a DSO, and is not sure the evidence supports such a finding in any event; (11) The ex-wife is bound by the terms of the confirmed plan and barred from pursuing an end run around it; (12) Her motion is denied

(Appeal to the District Court filed on 5/3/22 – Case 5:22-cv- 00026 (Dillon))

9. **Moore v. Berry** (**In re Moore**), 21-03041-KLP (Bankr. E.D. Va. 3/21/22) (Phillips).
Both the Trustee and the Debtor can bring avoidance actions pursuant to Sections 544, 548, and 550.

Pursuant to Code Sections 544, 548, and 550, and Virginia Code Section 55.1-401, Debtor and Trustee filed a joint A.P. to avoid transfers of real property made from the Debtor to the Defendant less than two years before the case was filed. Defendant moved to dismiss the complaint for failure to state a claim.

Discussion: (1) Courts differ on whether a Chapter 13 Trustee has the authority to bring avoidance actions under these Code sections. The Lundin treatise concludes that the failure to list a Chapter 7 Trustee's 704(a)(1) powers of collection and liquidation in the Chapter 13 Trustee's 1302(b)(1) duties does not preclude the latter's use of those powers. (2) Courts have also relied on policy concerns and legislative history to hold that the Code grants such avoidance powers to a Debtor. (3) So authority exists for finding that either the Trustee or the Debtor can bring avoidance actions in a Chapter 13 case. (4) The Court therefore rejects the Defendant's argument that the co-plaintiffs both lack standing to bring this A.P.; either of them has standing to bring these actions. (5) Chapter 13 Trustees need to have these powers to prevent the denial of relief to otherwise qualified Debtors. (6) The Fourth Circuit, in the Wilson case, 717 F.3d 337 (2013), recognized the necessity of permitting a Debtor to exercise Trustee powers in a Chapter 13 case, so expanding the Debtor's sec. 1303 powers to include recovery of avoidable transfers is appropriate. (7) Reading the complaint in the light most favorable to Plaintiffs, it has satisfactorily pled the required elements of Code sec. 548(a)(B)(ii)(I); the Defendant's contrary allegations are factual issues which must be resolved later. (8) The second count, under sec. 544(b), has properly cited VaC 55.1-401 as the applicable law and pled the necessary elements of that provision. (9) The third count, under sec. 544(a), giving the Trustee the rights of a BFP, sets out sufficient facts to support a cause of action under that statute. (10) The affirmative defense raised by the Defendant, *in pari delicto*, is not properly considered in a motion to dismiss because the Plaintiffs have not been foreclosed from making a rejoinder by the terms of their Complaint. (11) The Defendant has cited no persuasive authority for its argument that these avoidance actions should be stopped because the Chapter 13 plan currently provides sufficient funds to pay all claims in full from the Debtor's future income, and the Debtor's ability to do this is "speculative at best." (12) When such potential recoveries exist, it is "generally in the best interest of…creditors to make those recoveries," and the Debtor may even have an obligation to preserve and pursue such actions. (13) The motion to dismiss is denied.

Held: "Defendant has failed to carry its burden of showing that the Plaintiffs have not alleged plausible claims for relief. Further, the Court finds that the Chapter 13 Trustee and the Debtor have standing in this case to pursue the avoidance actions alleged in the Complaint. Accordingly, the Motion to Dismiss will be denied."

10. Johnson v. IRS (In re Johnson), #15-70541, A.P. #21-07009 (Bankr. W.D. Va. 5/2/22) (Black)
Debtor's unfiled tax debts deemed non-dischargeable despite the IRS' assessment of taxes due.

This matter was before the Court on cross motions for summary judgment regarding whether or not the Debtor's 2005 and 2006 tax debts were non-dischargeable. The IRS assessed liability under 26 U.S.C. Section 6020(b). 11 U.S.C. Section 523(a)(1)(B)(i) excepts from discharge debts for taxes in which a return is required but not filed. Section 523(a)(19)(B)(iii) defines return to exclude returns made by the IRS under Section 6020(b). The Debtor did not file a return in either 2005 or 2006 and the IRS' assessment of those tax liabilities under Section 6020(b) precludes the Debtor from receiving a discharge as to these debts.

Held: The Court found the debt to be non-dischargeable and granted summary judgment in favor of the IRS.

II. IMPORTANT CASES: FOURTH CIRCUIT

1. **Catjen, LLC v. Hunter Mill West, L.C.**, 19-1790 (4th Cir. 7/8/21)
[Unpublished per curiam opinion.]
After a note matured, interest compounded at the note's post-judgment rate, not at the federal post-judgment rate.

District Court's opinion is affirmed. The note provided that after a court-entered judgment on the note, the judgment would bear interest at the default rate of 24% (pre-maturity rate was 14%). Defendant's expert in seeking to reduce the amount of the judgment to be awarded by the Bankruptcy Court had calculated compounding interest from the maturity date through the date on which a bankruptcy case was filed. Therefore the defendant is precluded from relitigating the issue of post-maturity compounding interest. There is no basis for concluding that the filing of the bankruptcy case altered the defendant's obligations under the note. The claims order is preclusive as to the appropriate method for calculating interest after maturity, so that issue cannot be re-litigated. The federal post-judgment interest rate [28 USC sec. 1961(a)] does not apply, because the parties are free to stipulate by contract a different rate consistent with state usury and other applicable laws, provided they do so "…by clear, unambiguous, and unequivocal language," and they did so here.

2. **Alexander v. Carrington Mortgage Services, LLC**, 20-2359 (4th Cir. 1/19/22) (Wilkinson).
Court interprets Maryland consumer protection acts that partially incorporate the FDCPA.
[Appeal from the District Court in Baltimore MD]

Plaintiffs brought a class action against Carrington Mortgage Services, LLC ("Carrington") under the Maryland Consumer Debt Collection Act ("MCDCA") and the Maryland Consumer Protection Act ("MCPA") because Carrington was charging a $5 convenience fee to borrowers who paid monthly mortgage bills online or by phone. <u>Facts:</u> The MCDCA incorporated provisions of the Fair Debt Collection Practices Act ("FDCPA") that prohibited charging any fee not expressly authorized by the contract or threatening to enforce a right that does not exist. The MCPA forbade unfair, abusive, or deceptive trade practices in the collection of consumer debts. The former makes the violator liable for actual damages; the latter allows reasonable attorney fees to a successful plaintiff. The contract allowed payments by check, cash, or money-order; Carrington later gave the Plaintiffs the additional option to pay online or by phone for a $5 convenience fee, to which the Plaintiffs agreed. The District Court dismissed the action, holding that Carrington was not a "collector," that the option was permitted by law, that the fees were not "incidental" to the mortgage debt, and that none of the mortgage documents expressly prohibited the fees.

<u>Held:</u> (1) These statutes are remedial consumer protection statutes, and must be "liberally construed." (2) Carrington was a "collector" that charged an amount not expressly authorized by the contract in violation of the FDCPA, so the District Court's dismissal is reversed. (3) Court declines to distinguish between loan servicing and debt collection as requested by Carrington. (3) Plaintiffs need not challenge the "method of collection" here; that argument was rejected by the MD Court of Appeals. (4) The FDCPA definition of "debt collector" doesn't apply because the MD statute doesn't require that the debt be in default; state law need not totally incorporate federal law, and states may incorporate it "to the extent they see fit." (5) The charged fees are an "amount" under the FDCPA; it forbids "any" amount without the need for one to be "incidental" to the mortgage. (6) These fees were not "permitted by law": that would require affirmative sanction or approval, not merely "a lack of express prohibition." To allow debt collectors to "subsequently modify the terms of the original agreement as they see fit, based on the mere absence of legal prohibition, would thus frustrate the FDCPA's goals." (7) The fact that the Plaintiffs later agreed to these charges does not change the result. (8) The MCDCA claim is remanded to the District Court, but the MCPA claim cannot proceed: the Plaintiffs did not state a plausible claim for relief. (9) The District Court's decision is affirmed in part, reversed in part, vacated in part, and remanded for further proceedings.

3. **Cook v. United States (In re Yahweh Ctr)**, 20-1685 (4th Cir. 3/8/22) (Quattlebaum).
Trustee cannot use Code sec. 544 or 548 to avoid pre-petition Debtor payments on tax penalty obligations. [Chapter 11]

Facts: The Yahweh Center was a non-profit corporation which provided residential help to at-risk children. It failed to pay certain taxes owed to North Carolina and the IRS; the IRS eventually filed tax liens to secure the payment of the taxes. The IRS filed a claim in this case for secured, priority, and general unsecured claims. The appointed Chapter 11 Trustee sued the United States under Code sections 544(b)(1) and 548(a)(1)(B) to void tax penalty obligations owed by the Debtor to the IRS and to recover prior payments made by the Debtor upon those obligations. He alleged that these payments were constructively fraudulent transfers because the Center did not receive "reasonably equivalent value" for the payments. The Bankruptcy Court dismissed the Trustee's claims, and the District Court affirmed.

Held: (1) Sec. 544(b)(1) is not a substantive cause of action; it is only a procedural vehicle for relief if an "applicable law" allows an unsecured creditor to void a transfer or obligation. (2) The applicable law in this instance is the NC Uniform Voidable Transactions Act ("the Act"), which allows avoidance if there was no reasonably equivalent value in exchange and the debtor was insolvent at the time of, or became insolvent as a result of, the transfer. The Act allows an unsecured creditor to sue the transferee, so the bankruptcy Trustee can step into the shoes of an unsecured creditor. (3) On the issue of sovereign immunity: Code sec. 106(a)(2) allows the Bankruptcy Court to hear any such issues, and 106(b) says by filing a claim the US has waived this defense. (3) The Sixth Circuit heard this issue, and rejected the same arguments being made by the Trustee. These penalties are not within the obligations contemplated by the Act. There was no oral agreement, no written record, and the IRS had no choice but to impose these penalties. (4) It is inappropriate to apply fraudulent transfer provisions to tax penalties, so the Trustee's challenge is dismissed; same result regarding previous payments of the tax penalty obligations. (5) We agree with the District Court that a dollar-for-dollar reduction in the tax obligation does constitute "reasonably equivalent value," but our decision rests upon the legitimacy of the underlying tax penalty obligation, not the dollar-for-dollar reduction.

4. **Beckhart v. Newrez LLC**, 21-1838 (4th Cir. 4/15/22) (Heytens),
[Chapter 11] The Supreme Court's *Taggart* opinion setting a "no-fair-ground-of-doubt" standard for civil contempt in a Chapter 7 case also applies to other Chapters.

In *Taggart v. Lorenzen*, 139 S.Ct. 1795 (2019), the Supreme Court addressed "the proper standard for holding a creditor in civil contempt for attempting to collect a debt" that that had been discharged in a Chapter 7 case.

Issue: Does that standard apply when a court is considering holding a creditor in civil contempt for violating a Chapter 11 reorganization plan? Facts: Per the plan, the Debtors maintained possession of a beach house and the creditor retained its secured claim for the full mortgage balance; payments were 10 months in arrears at filing. The confirmed plan failed to specify the amounts due for subsequent payments or how they would be calculated, and provided for ten days' notice before foreclosure could commence. Debtors made regular payments for several years, but when Shellpoint became the loan servicer it believed the Debtors were in default because of the missed pre-petition payments, and it proceeded to send notices of default for five years. In 12/19 Shellpoint acknowledged that the previous servicer had not adjusted the loan to conform with the confirmed plan and made major adjustments to the loan, but it commenced foreclosure anyway without noticing the Debtors. Finding out about the foreclosure by a notice tacked onto the house, the Debtors filed an emergency motion for contempt. The Bankruptcy Court found Shellpoint in contempt, finding clear and convincing evidence of the four factors set forth in *Ashcroft v. Conoco*, 218 F.3d 288 (4th Cir. 2000); it awarded $114,569 in damages for the Debtors' time, the loss of their "fresh start," travel expenses, and attorneys' fees. The District Court reversed, holding that the *Taggart* standard applied and there was a "fair ground of doubt with regard to the unclear terms of the confirmation order."

Held: (1) *Taggart* does apply to violations of Chapter 11 confirmation orders, and the Bankruptcy Court did not correctly apply that standard. (2) Nothing in the Supreme Court's analysis suggests that it's limited to violations of Chapter 7 discharge orders. It noted that sec. 105 and 524(a)(2) incorporated traditional principles of equity practice, and that courts did not have unlimited authority to hold creditors in civil contempt. It termed the standard for civil contempt an "objective one," and inappropriate where there is a "fair ground of doubt" as to the wrongfulness of the defendant's conduct." (3) A Bankruptcy Court's authority to enforce its own orders, "regardless of which chapter of the Bankruptcy Code those orders were issued under," derives from the same statutes and general principles relied on by the Supreme Court in *Taggart.* (4) The Bankruptcy Court did not apply the correct legal standard of "no-fair-ground-of-doubt." (5) But the District Court also erred in granting controlling weight to the fact that Shellpoint was acting on the advice of counsel; we have previously held that advice of counsel is not a defense to civil contempt. (6) Since there were errors by both lower Courts in analyzing the threshold question of whether Shellpoint could be held in civil contempt at all, the matters is remanded to the Bankruptcy Court to consider the contempt motion under the correct legal standard.

5. **Anderson v. Morgan Keegan & Co. (In re Infinity Bus. Grp.)** 21-1536 (4th Cir. 4/19/22)(Heytens)
(Chapter 7) Trustee may not proceed with lawsuit against investment advisor because he stands in the shoes of the Debtor with unclean hands.

"Infinity Business Group used a dodgy accounting practice that artificially inflated its accounts receivable and therefore its revenues. The company's CEO cooked up the practice, and the board of directors and outside auditors blessed it. Many of these wrongdoers have already been held responsible for their conduct through civil lawsuits, criminal charges, or both.

Yet Infinity's bankruptcy trustee remains unsatisfied. He insists the true mastermind was a financial services company Infinity contracted with to (unsuccessfully) solicit investments. But even assuming-contrary to the bankruptcy court's scrupulous factfinding-that the financial services company played some role in creating or perpetuating the flawed accounting technique, the trustee still cannot succeed in holding the financial services company liable. As both the bankruptcy and district courts correctly held, the trustee's claims run headlong into the longstanding principle that one wrongdoer cannot recover from another for joint wrongdoing. We thus affirm …

This Court has recognized that a trustee generally acts as "the representative of the estate," 11 U.S.C. § 323(a), and therefore "can . . . assert those causes of action possessed by the debtor" as part of the power to secure the "estate" under 11 U.S.C. § 541(a). Grayson Consulting, 716 F.3d at 367 (quotation marks omitted). When exercising such powers, however, a trustee "stands in the shoes of the debtor" and is "subject to the same defenses as could have been asserted against the debtor." Id. (quotation marks and emphasis omitted). We have specifically held that this includes in pari delicto, stating: "[T]o the extent that in pari delicto would have barred a debtor from bringing suit directly, it similarly bars a bankruptcy trustee-standing in the debtor's shoes-from bringing suit." Id. For that reason, the trustee is plainly subject to in pari delicto to the extent he brings this action under Section 541.

As the trustee correctly notes, however, the Bankruptcy Code grants trustees certain powers beyond those of the debtor, including the ability "to, in essence, step into [a] creditor's shoes to do the same thing [that] creditor could do." Cook v. United States, 27 F.4th 960, 965 (4th Cir. 2022) (quotation marks omitted) (emphasis added). As relevant here, 11 U.S.C. § 544(a)(1) grants a trustee the powers of a hypothetical judgment lien creditor-that is, if a creditor holding a judgment lien against the debtor could pursue a particular action on the debtor's behalf, the trustee may do so too even if no actual creditor holds such a lien. See Angeles Real Estate Co. v. Kerxton, 737 F.2d 416, 418 (4th Cir. 1984). The trustee's argument that he may evade in pari delicto by proceeding instead under

Section 544(a)(1) therefore raises two questions: (1) would a judgment lien creditor be able to bring the debtor's causes of action under "applicable state law," Angeles Real Estate, 737 F.2d at 418; and (2) if so, would that (again, hypothetical) creditor be subject to in pari delicto? …

After an 18-day bench trial, the bankruptcy court entered judgment in favor of Morgan Keegan and Meyers. The court found the trustee failed to prove the essential elements of any of his claims. It also concluded all of the trustee's claims were barred by an affirmative defense known as in pari delicto, which bars recovery by a plaintiff who "bears equal or greater fault in the alleged tortious conduct" than the defendant. JA 292. Rejecting the trustee's efforts "to frame [Infinity] as a neophyte to the world of securities and raising capital that relied heavily on Meyers and Morgan Keegan for advice," the court found Infinity, "through its management, bears the greater fault in this matter for the implementation and consequences of the use of the" faulty accounting technique. JA 328.

The trustee appealed to the district court, which agreed with the bankruptcy court's conclusions on both the elements of the claims and in pari delicto and therefore affirmed. … "

<u>Held:</u> "We hold only that when a trustee pursues a right of action that ultimately derives from the debtor-even if the trustee is nominally exercising a creditor's powers when doing so-the trustee remains subject to the same defenses as the debtor …

As the bankruptcy court found, Infinity's officers and auditors were the authors of the company's demise-not Morgan Keegan or Meyers. At worst, the latter simply failed to stop a ship that was already sinking, and the law does not hold them responsible for that failure. The judgment in favor of Morgan Keegan and Meyers is therefore AFFIRMED."

<u>III.</u> <u>IMPORTANT CASES: U.S. SUPREME COURT</u>

1. **<u>Siegel v. Fitzgerald</u>**, #21-441,; certiorari granted, 1/10/22.
   Issue: Whether the Bankruptcy Judgeship Act violates the uniformity requirement of the Constitution's bankruptcy clause by increasing quarterly fees solely in districts under the U.S. Trustee program, not in those under the Bankruptcy Administrator program.

   Oral argument was held on 4/20/22, and a decision is expected in late June.

   The Fourth and Fifth Circuits found no constitutional violation. *See Siegel v. Fitzgerald (In re Circuit City Stores Inc.*, 996 F.3d 156 (4th Cir. April 29, 2021); *Hobbs v. Buffets LLC (In re Buffets LLC)*, 979 F.3d 366 (5th Cir. Nov. 3, 2020). Two other circuits found violations of the Bankruptcy Clause. *See Clinton Nurseries Inc. v. Harrington (In re Clinton Nurseries Inc.)*, 998 F.3d 56 (2d Cir. May 24, 2021); and *John Q. Hammons Fall 2006 LLC v. U.S. Trustee (In re John Q. Hammons Fall 2006 LLC)*, 20-3203, 2021 BL 380406 (10th Cir. Oct. 5, 2021).

2. **<u>In re</u> Bartenwerfer,** #21-908, certiorari granted, 5/2/22; Appeal from the Ninth Circuit.
   Issue: Can a debtor discharge a debt arising from a partner's fraudulent act when they are jointly liable?

   The Court has agreed to hear a case from San Francisco involving a married couple that specialized in flipping houses and sold a house in 2008 for $2 million without disclosing to the buyer water leaks and other problems. A jury awarded the buyer $444K in damages, which a state judge reduced by almost half. They later filed for personal bankruptcy, and the wife sought to discharge the buyer's judgment against her, saying her husband was responsible for the renovation and that she wasn't aware of the problems. The Ninth Circuit ruled against the wife, holding that her debt wasn't eligible for a bankruptcy discharge regardless of her knowledge of the fraud.

IV. LEGISLATIVE AND ADMINISTRATIVE CHANGES

1.Amendments to the Rules

A. **Rule 3007:** The Rule was amended effective 12/1/21 to clarify that the special service requirements of Rule 7004(h) apply only to insured depository institutions as defined in Section 3 of the Federal Deposit Insurance Act. The requirement of certified mail to an officer does not apply to institutions not insured by the FDIC, such as credit unions; they can be served by first-class mail sent to the person designated for receipt of notice on the proof of claim.

B. **Rule 9036:** The Rule was amended effective 12/1/21 to allow for certain documents to be served electronically rather than by sending a notice or serving paper. Designed for high-volume recipients, it allows the Clerk to send notices to registered users by using CM/ECF and by electronic means if the recipient has consented to such service. Such electronic service is deemed to be complete upon sending, and the burden is on the recipient to keep its electronic address current with the Court.

2.Amendments to the Code

A. **Section 109(e):** The tri-annual adjustment of dollar amounts meant that as of 4/1/22 THE Chapter 13 debt limits were raised from $419,275 to $465,275 for unsecured debt, and from $1,257,850 to $1,395,875 for secured debts.

B. **Senate Bill S. 3823**: This bill (the "Bankruptcy Threshold Adjustment and Technical Corrections Act"), introduced by Senator Grassley on 3/14/22, would, among other things, amend Code section 109(e) to change the debt limit for Chapter 13 to a single limit of $2,750,000 without distinguishing between secured and unsecured debt. The bill passed the Senate on 4/7/22 and has been sent to the House.

C. **Status of proposed "Chapter 10" legislation:** The 188-page Consumer Bankruptcy Reform Act of 2020 ("the CBRA") [S. 4991, 116th Congress] was introduced by Senator Warren and Congressman Nadler in late 2020. It would repeal Chapter 7 and Chapter 13 and replace it with a new Chapter 10. The eligibility limit would be $7.5 million. Below-median Debtors would be directed into a Chapter 7-like no-payment case, and above-median debtors would be directed into a Chapter 13-like repayment plan. In both situations debtors would receive an early discharge. Exemptions would be significantly increased, mortgages could be modified, and certain student loans could be discharged. Debtors could propose "limited proceedings" which deal with only certain debts, and attorney fees could be paid over time. The bill died without committee action, but it is anticipated that it will be introduced again.

3. **Other:**

Consumer Financial Protection Bureau (CFPB) new Debt Collection Rule. The CFPB has issued a Debt Collection Rule in November, 2021, to clarify requirements under the Fair Debt Collection Practices Act. The Rule details such issues as the contents of a first communication from a debt collector, how often they can call, what they can report to a credit reporting company, limitations on social media contact, and contents of voice mail collection efforts. A FAQ for the Rule is attached.