Practical Practice Points:
SPEAKERS: **Jill A. Michaux & Honorable Cynthia A. Norton**
Southeastern Bankruptcy Law Institute
March 21-23, 2019
Atlanta, GA

FIVE VEXING BANKRUPTCY QUESTIONS I WISH I KNEW THE ANSWER TO OFF THE TOP OF MY HEAD[1]

I.

Garnishments: What is really supposed to happen with a pending garnishment when a bankruptcy case is filed?

- **Automatic Stay Bars Garnishing Creditor's Independent Action Against Nondebtor Garnishee-Employer; Split of Authority Noted. *In re Johnson*, 479 B.R. 159 (Bankr. N.D. Ga. 2012)**

A judgment creditor had served a prepetition garnishment on the judgment debtor's employer. However, the employer failed to comply with state law to effectuate the garnishment before the debtor filed a Chapter 7 case. Ultimately, the judgment creditor obtained a post-bankruptcy judgment against *the employer* under state law for the amount the employer should have withheld. The creditor moved for relief from stay to pursue the employer. In turn, the debtor asserted that the creditor had violated the stay in pursuing the garnishment after the bankruptcy was filed. Judge Paul Bonapfel discussed the application of the automatic stay as to garnishments in great detail, as follows:[2]

> In some instances, application of the automatic stay in the garnishment context is clear. Thus, a garnishment action commenced after the filing of the petition is void, and the creditor must dismiss it. In the case of a continuing wage garnishment, the automatic stay imposes an affirmative obligation on the creditor to take "careful and deliberate steps" to stop the employer's withholding of postpetition earnings, even if service of the summons of garnishment occurred prior to the filing of the petition.
>
> Funds owed to a debtor or other property of the debtor in the garnishee's possession or control that are subject to a garnishment summons are property of the estate under 11 U.S.C. § 541(a). Funds or property in the custody of the

[1] Materials prepared by Erica Garrett and Kristi Sutton, law clerks to Chief Bankruptcy Judge Cynthia A. Norton, United States Bankruptcy Court for the Western District of Missouri, for the 45th Southeastern Bankruptcy Law Institute Seminar on Bankruptcy Law and Rules, March 21-23, 2019.

[2] Judge Bonapfel also described in great detail Georgia's garnishment process applicable at the time. The garnishment statutes in effect at that time have since been amended by the Georgia legislature due to constitutional concerns over certain aspects of the prior law. For a discussion of Georgia's current garnishment process, see John Padesky, *Navigating Georgia's New Wage Garnishment Law*, 10 J. Marshall L.J. 76 (2016-2017).

> garnishment court at the time of the bankruptcy filing are also property of the estate.
>
> Paragraph (3) of § 362(a) stays any act to obtain possession of property of the estate or to control property of the estate. Thus, the automatic stay prevents a creditor from seeking disbursement of funds or property in the garnishment court's custody or from seeking to compel a garnishee to deliver funds or property to the garnishment court. Specifically, the automatic stay prohibits any act to enforce a garnishee's obligation to answer a garnishment summons and to deliver funds or property subject to garnishment to the garnishment court.
>
> The automatic stay does not, however, require a dismissal of the garnishment action, a release of the garnishment, or disbursement to the debtor of funds or property already in the garnishment court's registry or subject to a pending garnishment summons as of the date of the bankruptcy filing. The creditor's lien attaches to garnished funds or property upon service of the summons of garnishment or, in the case of earnings that occur after service of the summons, when they are earned. Moreover, the filing of a bankruptcy case does not affect a creditor's lien unless some proceeding occurs in the bankruptcy case with regard to the lien. At the time of the filing of the bankruptcy case, therefore, any garnished funds or property remain subject to the creditor's garnishment lien.
>
> . . . [A] debtor in some circumstances may be entitled to garnished funds or property through exercise of her rights to exempt them and avoid the garnishment lien under 11 U.S.C. § 522(f). A debtor may also be able to exempt garnished funds or property that a trustee may recover as a preferential transfer under 11 U.S.C. § 547, and may prosecute the preference claim if the trustee does not.
>
> Nevertheless, the fact that a debtor has the right to garnished funds under the Bankruptcy Code by following proper procedures does not mean that a creditor's refusal to dismiss the garnishment action or to effect the disbursement of funds to the debtor by dismissing the garnishment action is a violation of the automatic stay.

In re Johnson, 479 B.R. at 170-171 (citations omitted).

Ultimately, the court held that the creditor had violated the stay in the garnishment action by continuing to pursue the employer after the filing of the case. Thus, the post-petition pleadings were void. Further, the court modified the stay to permit the employer to defend itself in the state court action.

In so ruling, Judge Bonapfel disagreed with Judge Mary Grace Diehl's earlier decision in ***In re Roche*, 361 B.R. 615 (Bankr. N.D. Ga. 2005)**, which held that a garnishment creditor has an affirmative duty to release a prepetition garnishment. According to Judge Bonapfel:

In *Roche,* the court ruled that a creditor violated the automatic stay by failing to dismiss a prepetition garnishment to permit the debtor to receive funds garnished from her bank account. The Court must respectfully disagree with the *Roche* analysis.

. . . [T]he debtor in *Roche* was apparently entitled to the funds because she could claim them as exempt and avoid the creditor's lien under 11 U.S.C. § 522(f). But the debtor was not entitled to the funds at the time of the filing of her petition because she had not yet prosecuted her exemption and lien avoidance rights.

In this regard, it is noteworthy that a debtor is not entitled to exempt property until she claims it as exempt and the time for an objection to the exemption (30 days after the conclusion of the § 341(a) meeting under Fed. R. Bankr. P. 4003(b)) has expired. 11 U.S.C. § 522(*l*). Furthermore, dismissal of a debtor's case results in reinstatement of any lien on exempt property that has been avoided. 11 U.S.C. § 349(b). So at least at the outset of the case, the rights of a debtor to garnished funds that are subject to the creditor's lien cannot possibly be established.

As earlier text notes, a bankruptcy filing alone does not affect a creditor's garnishment lien. . . . The conclusion that the automatic stay requires a creditor to dismiss a pending garnishment upon the filing of a bankruptcy case effectively eliminates the creditor's lien without any action in the bankruptcy court, thus contradicting this principle. Moreover, requiring the creditor to eliminate its lien immediately upon the filing of the case fails to take account of the creditor's rights to be heard with regard to the debtor's claims of exemptions and the avoidance of its lien and the fact that the debtor is not at that time entitled to the exempt property.

In *Roche,* the garnishing creditor had filed a notice of the automatic stay in the garnishment action. This action was sufficient to maintain the status quo with regard to the garnished funds pending the determination of the rights of the parties to the funds in the bankruptcy court.

Arguably, a garnishing creditor's failure to dismiss a garnishment action amounts to an attempt to exercise control over property of the estate in violation of § 362(a)(3). Perhaps, but the filing of the notice of the automatic stay in the garnishment action would indicate, instead, an act to maintain the status quo pending later events in the bankruptcy court.

Even so, this does not advance a debtor's claim of an injury arising from the funds remaining in the garnishment court because she is not yet entitled to them in any event. At the time of the filing of the case, the proper recipient of the funds is the trustee. 11 U.S.C. § 542(a), (b). And because the creditor's lien

> attaches to the garnished funds unless it is avoided, the trustee cannot do anything with the funds except hold them.
>
> Because the garnishment lien encumbers the garnished funds or property until the garnishment lien is avoided, the Bankruptcy Code's restrictions on the use of encumbered property apply. Thus, the court may condition the use of garnished funds or property on the provision of adequate protection under 11 U.S.C. § 363(e). Further, funds subject to a garnishment lien are "cash collateral" under 11 U.S.C. § 363(a) (because the funds are cash in which the garnishing creditor has an interest by virtue of its garnishment lien). Therefore, a bankruptcy trustee cannot use the funds without the consent of the creditor or an order of the court that provides adequate protection. 11 U.S.C. § 363(c)(2).
>
> Whether § 362(c)(2) applies in a Chapter 13 case to a debtor's use of cash collateral to make plan payments or to pay ordinary living expenses is not clear. See W. Homer Drake, Jr., et al., Chapter 13 Practice and Procedure § 6:4. Nevertheless, a judgment creditor clearly has the right in a Chapter 13 case to adequate protection as a condition to the debtor's use of the funds under § 363(e).
>
> A creditor's failure to dismiss a garnishment action in which it has filed a notice of the automatic stay means that garnished funds or property remain in the garnishment court where they are not going to go anywhere pending further events in the bankruptcy case. This is not the type of "control" over property of the estate that the automatic stay properly prohibits. Indeed, the alternative – substitution of the trustee as the stakeholder to hold the funds pending further events in the bankruptcy case – does not serve any bankruptcy purpose and, in fact, creates administrative and bookkeeping burdens for a trustee, especially in a "no asset" case.
>
> A garnishment court's holding of garnished funds or property for disbursement in accordance with later orders obtained through proper procedures in the bankruptcy court does not in any way offend the bankruptcy court's jurisdiction over the property or the rights of any parties with an interest in it. This being the case, no reason exists to conclude that a party who fails to take action to change that result is exercising any type of control over property of the estate that violates the automatic stay.

In re Johnson, 479 B.R. at 171 n. 56 (citation omitted).

- **Debtor's Employer Had Standing to Seek Stay Enforcement. *In re Cole*, 552 B.R. 903 (Bankr. N.D. Ga. 2016)**

In this case, Judge James Sacca disagreed, in part, with Judge Bonapfel's *Johnson* decision discussed above. In *Cole*, a judgment creditor filed a prepetition garnishment action in state court and obtained a default judgment against the debtor's employer for the amount which should have been garnished. After the employer filed a motion to vacate the default judgment,

but before the state court ruled on that motion, the debtor filed a Chapter 13 bankruptcy case. Soon after the filing, the bankruptcy court entered an employer wage deduction order stating, among other things, that the automatic stay "stays the continuation of any garnishment proceeding."

Notwithstanding the bankruptcy filing and the wage deduction order, the judgment creditor continued the action against the debtor's employer without obtaining relief from the stay. The *state court* ruled that the automatic stay did not apply to the proceeding against the employer, since the employer was independently liable to the creditor under the garnishment and default judgment. The state court set the motion to vacate the default judgment for a future hearing. This prompted the employer to file a motion to enforce the automatic stay in the bankruptcy court.

At the outset, the bankruptcy court concluded that the *Rooker–Feldman* doctrine did not prevent it from determining the applicability of the automatic stay in light of the state court's ruling on the issue, largely because the doctrine does not apply when parallel state and federal litigation are ongoing. In addition, and noting a split of authority, the court held that the automatic stay is one of the most fundamental protections that the Bankruptcy Code provides to debtors, and bankruptcy courts have exclusive jurisdiction to grant relief from the automatic stay. The court held that if a state court incorrectly determines that the stay does not apply, then it is, in effect, granting relief from the automatic stay – something only bankruptcy courts have authority to do.

Next, the court held that the employer had constitutional standing to bring the motion. In addition, § 362(k) states that "an individual" may seek damages for a violation of the stay, and does not limit the ability to seek damages solely to a debtor. Consequently, the court held, third parties other than the debtor must have standing to seek damages and enforce the automatic stay.

Moreover, the court held, the judgment creditor's action violated the employer wage deduction order which had been entered in the bankruptcy case.

Finally, the court addressed the application of the automatic stay. In so doing, the court noted that "it is straightforward that the automatic stay applies to the extent the creditor seeks to collect against the debtor, the debtor's property or from property of the estate." It agreed with *Johnson* that the automatic stay stays the garnishment of the debtor's postpetition wages and prevents the disbursement of funds garnished prepetition to the creditor. However, the issue in this case was whether the stay applied to prevent a judgment creditor from enforcing a prepetition default judgment against *the garnishee* based on the garnishee's independent liability to it for failure to comply with state garnishment law. The court distinguished *Johnson*:

> The facts in *Johnson* are substantially and materially different than those before this Court. In *Johnson,* a judgment creditor filed a garnishment action against the debtor's employer. About an hour and a half before the clerk's office closed in the state court where the garnishment action was pending on the final day that the garnishee could file an answer, the debtor filed for Chapter 7 bankruptcy relief. At the time of the bankruptcy filing, the employer had not filed an answer in the

garnishment action. In the bankruptcy case, the judgment creditor initially filed a motion for relief from the automatic stay to proceed against the employer to compel payment of the debtor's pre-petition wages into the state court. After learning the employer did not withhold wages subject to the garnishment, but without actually obtaining relief from the stay, the judgment creditor filed two documents in state court, one of which sought entry of default judgment for more than $210,000. The debtor and employer both opposed the motion for relief from stay.

Johnson adopted the approach by courts that conclude the automatic stay is not implicated when a creditor continues a garnishment action against the garnishee only if the garnishee's independent liability already exists by way of a judgment. It concluded that the automatic stay applied to the garnishment action in its entirety on the facts before it, including staying the obligation of the employer to answer or deliver funds to the state court because the employer's independent liability did not exist at the time the bankruptcy case was filed. It did, however, lift the automatic stay to allow the judgment creditor to proceed with its state law rights and remedies against the garnishee on account of the garnishee's failure to withhold property subject to the garnishment prior to the petition, but only after giving the garnishee additional time to answer the garnishment. In deciding to lift the automatic stay, *Johnson* stated: "We now know that the Employer did not withhold earnings from the Debtor as the garnishment law requires and that, therefore, the Bank's prosecution of the garnishment action is the prosecution of an independent claim against the Employer and does not involve property of the estate." Similarly, later on, *Johnson* states: "The undisputed facts show that the Bank's claim against the Employer does not implicate property of the estate, property of the debtor or a claim against the Debtor. Under these circumstances, continuation of the stay does not serve a bankruptcy purpose."

It seems to this Court that based on the specific and limited facts before it, *Johnson* could have simply ruled that automatic stay applied to the garnishment action in its entirety because the time for the garnishee to answer had not run when the petition was filed and then modified the stay to allow the judgment creditor to proceed with its state law rights against the garnishee along the lines it did. Instead, *Johnson* went further and opined that the independent liability of the garnishee exists only when an "unmodifiable judgment" in the garnishment action exists and that garnishment actions in their entirety are stayed until such time. In the context of a default judgment, a fact situation not before it, *Johnson* defined the term "unmodifiable" to mean a final judgment after the expiration of the statutory sixty days within which a garnishee can file a motion to modify the default judgment provided for in O.C.G.A. § 18–4–91.

> Unlike *Johnson,* this Court has before it the specific fact that the Default Judgment was entered pre-petition and, after considering the legal implications of that fact, this Court disagrees with *Johnson*'s determination that a garnishee's independent liability pursuant to a prepetition default judgment is somehow protected by the automatic stay until the judgment becomes unmodifiable and concludes that the automatic stay does not stay the actions of [the garnishing creditor] against [the employer] because (1) the Default Judgment entered pre-petition against [the employer] is a final judgment which is enforceable under state law despite the modification period . . . , (2) the Default Judgment against [the employer] is only modifiable, after payment of the costs—which were not paid here, as to the amount of the liability, not the liability itself, under O.C.G.A. § 18–4–91 because it cannot be reduced to less than $50.00, (3) the Debtor is not even a party to this Garnishment Action under Georgia law because she did not file a traverse, which traverse should have been filed before the entry of the Default Judgment, (4) [the garnishing creditor] is not taking action to collect a debt of the Debtor or property of the Debtor or the estate, but rather pursuing an independent claim against [the employer], a non-debtor and (5) had [the employer] been in possession of property subject to the garnishment after the filing of the Debtor's bankruptcy case, which it was not, actions with respect to that property would have been protected by the automatic stay.

In re Cole, 552 B.R. at 913-915 (footnotes and citations omitted). The court concluded that since the automatic stay did not apply to the default judgment against the garnishee, except with respect to the portion of the proceeding regarding any property of the debtor or the estate held by the garnishee. As a result, the employer's motion to enforce the stay was denied.

Note that courts in Florida and Alabama have agreed with *Johnson*'s conclusion that the *Rooker-Feldman* doctrine does not bar a bankruptcy court from reviewing a state court's determination of whether the automatic stay applies. *See In re Goodson*, 2018 WL 722461 (Bankr. N.D. Ala. Feb. 5, 2018); *In re Long*, 564 B.R. 750 (Bankr. S.D. Ala. 2017), and *In re Clarke*, 373 B.R. 769 (Bankr. S.D. Fla. 2006).

- **Creditor's Refusal to Release Garnished Funds to the Detriment of Lien Rights Did Not Violate the Stay. *In re Giles*, 271 B.R. 903 (Bankr. M.D. Fla. 2002)**

In this case, a prepetition judgment creditor garnished the debtor's bank accounts prior to the bankruptcy filing, but the garnishee bank was still holding the funds at the time of filing. Noting a change in Florida law which gave the judgment creditor a lien upon the entry of the judgment (as opposed to when the writ of garnishment is served, as had been the prior law), and relying on *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995), Judge Michael Williamson held that where a creditor's lien might be destroyed if its collateral were released, the creditor must be provided adequate protection before being required to essentially turn over the account that is the subject of its lien by releasing its garnishment. Rather, the court held, the right of adequate protection cannot be rendered meaningless by an interpretation of § 362(a)(3) that would compel turnover even before an opportunity for the court's granting adequate protection.

Since the debtor had not offered adequate protection, the court held that the creditor's refusal to release its lien did not violate the automatic stay.

- **Judgment Lien Does Not Attach to Postpetition Wages. *Hann Fin. Serv. Co. v. Petrillo*, 2008 WL 11331997 (S.D. Fla. April 25, 2008)**

In this case, the district court for the Southern District of Florida held that *Giles*, discussed immediately above, did not apply to a creditor who refused to dissolve a writ of garnishment even as to wages earned *after the bankruptcy filing* because, in *Giles* and *Strumpf*, the lien (or hold on account, in the *Strumpf* case) was placed against existing funds in bank accounts. Here, the creditor refused to dissolve the writ of garnishment even as to wages that the debtor earned after his bankruptcy filing, "funds that did not exist at the time the writ was served." As a result, the judgment lien could not attach to them. *Accord,* ***In re Hernandez*, 2009 WL 3378495 (Bankr. S.D. Fla. 2009)** (holding that refusal to release a garnishment as to postpetition earnings violated the automatic stay because no prepetition lien rights were created in the postpetition funds). Thus, the district court affirmed the bankruptcy court's award of sanctions under § 362(k).

- **Dismissal of Garnishment is Not the Creditor's Only Alternative for Complying with the Automatic Stay. *In re Flanning*, 2017 WL 53036 (Bankr. M.D. Ala. Jan. 4, 2017)**

Here, the court held that while a judgment creditor must take affirmative action to stop garnishment proceedings – that is, to cease further postpetition wage deductions pursuant to the garnishment and stop the further distribution of the garnished funds – a dismissal of the garnishment is not the creditor's only alternative for complying with the automatic stay. Rather, the creditor can satisfy its duty either by dismissing the garnishment or having it stayed by the state court.

- **Garnished Funds Were Property of the Estate. *In re Lively*, 583 B.R. 534 (Bankr. M.D. Ala. 2017)**

In this case, judgment creditors of a Chapter 7 debtor – who was himself a creditor on a judgment that he had obtained against a third party – served their writ of garnishment on the clerk of court who was holding funds collected on the debtor's own writ of garnishment. This caused the clerk to not pay the funds over to debtor on the debtor's own judgment. The debtor filed a bankruptcy case and filed suggestions in bankruptcy with the state court. The judgment creditors filed an opposition to the suggestions in state court, thereby continuing their attempt to collect the funds. They then filed a motion for relief from stay in the bankruptcy case, with the debtor responding that the creditors had violated the automatic stay by opposing the suggestions of bankruptcy in the state court.

The bankruptcy court held that the funds which had been garnished prepetition to pay the judgment owed to the debtor became property of the estate upon his bankruptcy filing. The garnishment process was, therefore, stayed. Moreover, the creditors' garnishment lien did not attach to the debtor's judgment against the third party. While the creditors' garnishment lien

attached to the $578.95 in garnished wages that the clerk was holding before the automatic stay went into effect, the debtor was entitled to avoid the creditors' lien in its entirety as impairing his exemption rights. Accordingly, the court clerk was directed to turn this $578.95 over to the debtor.

II.

HOAs: Is there anything I can do in a bankruptcy case to help my client with past due HOA dues/assessments?

- **Ninth Circuit Holds That Postpetition HOA Fees and Assessments Are Dischargeable at Completion of Chapter 13 Plan Payments.** ***Goudelock v. Sixty-01 Association of Apartment Owners*****, 895 F.3d 633 (9th Cir. 2018),** ***cert. denied*****, 2018 WL 5282395 (Nov. 19, 2018)**

The debtor purchased a condo unit prepetition. The unit was subject to condo association assessments that came due after she filed a Chapter 13 case. The association's declaration provided, in accordance with state law, that unpaid assessments both (i) constituted a lien in the unit, enforceable through foreclosure, and (ii) created a personal obligation through which the association could sue the owner of the unit. Debtor had stopped paying the assessments in 2009, and the association initiated foreclosure, prompting the debtor to file Chapter 13 in 2011. As part of her plan, she surrendered the condo unit. The association filed a claim for nearly $19,000 in prepetition assessments, noting that they continued to accrue postpetition at almost $400 per month.

Before the plan was confirmed, the mortgage lender paid the outstanding assessments and the foreclosure was canceled. It again sat unoccupied until February 2015 when the mortgage lender foreclosed on it. Four months later, the debtor completed her plan payments and received her discharge. Meanwhile, shortly before her discharge, the association filed suit in the bankruptcy court to determine the dischargeability of the debtor's personal obligation to pay the postpetition assessments. The bankruptcy court granted summary judgment in the association's favor, concluding that the postpetition assessments "were not dischargeable because they arose at the time of their assessment and were and incidence of legal ownership of the burdened property."

The Ninth Circuit reversed. In doing so, the Ninth Circuit noted that there had been no court of appeals addressing this issue in a Chapter 13. However, there were two "polar opposite positions" in the context of Chapter 7: In ***In re Rosteck*****, 899 F.2d 694 (7th Cir. 1990)**, the Seventh Circuit held that condo assessments were an unmatured contingent debt that arise prepetition (when the debtor purchases the property) that merely mature when they become due postpetition. Thus, the postpetition obligation was dischargeable, consistent with the "fresh start." In ***In re Rosenfeld*****, 23 F.3d 833 (4th Cir. 1994)**, the Fourth Circuit held that the assessments "ran with the land" and arose each month from the debtor's continued postpetition ownership of the property. As postpetition obligations, they were not dischargeable.

The Ninth Circuit adopted the Fourth Circuit's reasoning and held it was applicable in the Chapter 13 context as well. It also said: "[The association] obtained two state law remedies under the [condo] Declaration to address the failure to pay [condominium association] assessments: an *in rem* remedy of a lien and right of foreclosure; and an *in personam* remedy allowing it to bring suit against the property owner. While the *in rem* lien is not dischargeable under Chapter 13, the

prepetition *in personam* obligation is. It is [the debtor's] *in personam* obligation that ultimately is at issue in this case."

It also noted with regard to § 523(a)(16) that the exception to discharge for certain postpetition association dues applies in Chapter 7, 11, 12, and – pursuant to § 1328(b) – Chapter 13 cases where a debtor is discharged without completing payments. But Congress notably omitted the exception in Chapter 13 cases where a discharge follows full payment under the plan – under § 1328(a) – which was the situation here. Further, § 1328(a)(1)-(4), which list the only exceptions to discharge under § 1328(a), does not refer to § 523(a)(16).

The court rejected the association's argument that, because the personal obligation to pay the assessments was a real property interest stemming from the condo declaration, the Fifth Amendment's Takings Clause prohibited the government from discharging the obligation, because *in personam* debts are dischargeable, but a creditor retains its *in rem* property interests.

Finally, the court rejected the associations equitable argument that it was unfair for the debtor to have enjoyed "free rent" for four years because the Code's express provision was clear.

In its ruling, the Fourth Circuit abrogated *In re Foster*, 435 B.R. 650 (B.A.P. 9th Cir. 2010), and *In re Batali*, 2015 WL 7758330 (B.A.P. 9th Cir. 2015).

- **Debtor Could Not Avoid Condo Association's Lien. *In re Doss*, 588 B.R. 516 (Bankr. E.D. Wis. 2018)**

In 2015, the debtor's condominium association filed a lien against the debtor's condo in the amount of $1,185 for unpaid assessments and initiated an action to foreclose. In early 2016, a stipulated order for entry of a foreclosure judgment and a money judgment in the amount of $8,300, with a one-year redemption period, were entered. Two days before the redemption period expired, the debtor filed a Chapter 13 case. He proposed to modify the first mortgage on the property and cure a pre-petition arrearage in excess of $63,000. If that did not work, then he intended to surrender the condo. The debtor's case was converted to Chapter 7 in October 2017, and closed on March 7, 2018, without entry of a discharge because the debtor failed to file his personal financial management certificate.

A few days later, the condo association proceeded to enforce its foreclosure judgment by scheduling a sheriff's sale. On April 5, the bankruptcy court reopened the debtor's case to allow him to file the certificate and receive his discharge. The court summarily denied the debtor's request to re-impose the automatic stay, however. The debtor responded by initiating an adversary proceeding seeking injunctive relief against the association and for avoidance of the lien as impairing his exemptions. The association moved to dismiss the complaint.

Finding no genuine issues of material fact, and treating the association's motion to dismiss as one for summary judgment, the bankruptcy court entered judgment for the association. Wisconsin law gave the association two remedies to recover delinquent assessments from a unit owner: a statutory lien which allowed the association to foreclose in the same way as a foreclosure of a mortgage, and the right to sue the debtor individually and obtain a money judgment for the unpaid assessments. The association had done both.

The court rejected the debtor's argument that the foreclosure of the non-avoidable statutory lien transformed it into an avoidable judgment lien. The court held that the foreclosure judgment was essentially an order of sale; it was not a lien and could not be avoided. The court reasoned that if it were to accept the debtor's argument that the enforcement of a statutory lien through judicial action rendered the lien "judicial," then "statutory liens would only be a theoretical possibility." An individual lienholder is not able to recover simply by possessing the lien. Rather, the court held, the lienholder must go to court and obtain a judgment against the debtor in order to be able to execute on the lien. This would leave creditors the choice of being able to recover by seeking a judgment or maintaining a statutory lien and not being able to recover, the court said.

The court concluded that the association's actions in enforcing its statutory lien and obtaining a foreclosure judgment did not alter the nature of its statutory lien and render it a judicial lien. The debtor's bankruptcy and subsequent discharge likewise had no effect on the rights created by the judgment of foreclosure that the association obtained in enforcing its statutory lien: "In Celtic lore, a selkie was a seal who could take human form on land, and become a seal again upon returning to the sea. Unfortunately for the debtor's argument, statutory liens do not have that same transformative quality and do not become avoidable judicial liens when the creditor returns with a money judgment."

- **HOA Dues Are Not a "Special Circumstance" Under §§ 1325(b) and 707(b)(2) for Plan Confirmation Purposes. *In re Groth*, 2018 WL 3583041 (Bankr. E.D. Wis. July 25, 2018)**

Section 1325(b)(1)(B) prohibits confirmation of a Chapter 13 plan over the trustee's objection if the debtor is not committing all of her "projected disposable income" to pay unsecured creditors. "Disposable income" means "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended . . . for the maintenance or support of the debtor or a dependent of the debtor." 11 U.S.C. § 1325(b)(2)(A)(i). For an above-median debtor, which the debtor here was, "amounts reasonably necessary to be expended" are determined in accordance with § 707(b)(2). 11 U.S.C. § 1325(b)(3). Section 707(b)(2) states that "[t]he debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides." Section 707(b)(2)(B)(i) permits debtors to reduce current monthly income further if they can demonstrate "special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional expenses or adjudgments of current monthly income for which there is no reasonable alternative."

Pointing out that homeowners and condominium dues are quite common, the court held that the debtor's dues were not a special circumstance, especially one on par with a serious medical condition or active military duty. While a homeowner's association dues might qualify as a special circumstance – such as where a disabled debtor whose disability requires her to live in a residence that carries atypically high association dues – the debtor had made no similar showing here. Her lack of a reasonable alternative to paying the dues was an insufficient basis on

which to allow her to deduct them. As a result, the court sustained the debtor's plan which had been based on allowing the deduction.

- **Court Calculates Condo Dues. *In re Peterson*, 2018 WL 1162515 (Bankr. D. Conn. March 2, 2018)**

The Chapter 13 debtor owned two units within the Laurelhart condominiums in Hartford, Connecticut, which were subject to assessment of monthly common charges on each unit. The property's bylaws provided that, in the event of a default, a unit owner was obligated to pay interest at 12% on unpaid assessments, plus expenses and attorney fees incurred in trying to collect. Prior to the filing of the case, Laurelhart commenced two foreclosures against the debtor for default in payment. In October 2010, the debtor filed a pro se Chapter 13 case. She filed a proof of claim on behalf of Laurelhart in the aggregate amount of $14,288 for unpaid prepetition condo fees. Throughout the course of the case, Laurelhart filed three motions for relief from stay, alleging that the debtor was delinquent in postpetition condo dues. The debtor defended the motions by arguing that she was withholding payment because of leaky roofs on the units. Ultimately, in 2014, the court granted relief on both units. However, the Chapter 13 trustee's report showed that the debtor had paid approximately $16,000 to Laurelhart between April 2013 and October 2014. As a result, the court issued an order to show cause why it should not reconsider the order granting relief from stay. It also directed Laurelhart to file an accounting of all postpetition common charges due from the date of the petition through September 2014.

After much litigation on whether the debtor was current on the dues, and commenting that "[t]he dispute that led to this ruling was fueled by missteps of both parties, including [the debtor's] defiance of court orders and failure to make payments when due and by Laurelhart's inability to cogently account for its claim," the bankruptcy court went through a painstaking 37-paragraph calculation of the fees due, concluding that the debtor's account should have a credit of $550. However, the court concluded that Laurelhart was nevertheless entitled to attorney fees totaling $6,900.

III.
Joint Cases: How are joint bankruptcy cases really supposed to work, particularly if the couple is fighting/estranged/divorcing or divorced?

A Married Couple Filing Jointly Does not Create a Joint Estate: section 302

For a helpful discussion on ethics and representing both spouses in bankruptcy, *see* 1 Collier Family Law and the Bankruptcy Code ¶ 1.08 (2018). *See also* Georgia Rules of Professional Conduct 1.7, regarding conflict of interest.

The Eleventh Circuit recognizes, pursuant to 11 U.S.C. § 302(a), "spouses may file joint cases." Once a joint case is filed, § 302(b) allows "the court [to] determine the extent, if any, to which the debtors' estates shall be consolidated." *Reider v. FDIC* (*In re Reider*), 31 F.3d 1102, 1105 (11th Cir. 1994).

Along with § 302 of the Bankruptcy Code, Federal Rule of Bankruptcy Procedure 1015 governs consolidation and joint administration of cases. Under this rule, the court balances creditors' interests and potential conflicts prior to ordering joint administration of the spouses' estates.

- **Filing a Joint Petition Does Not Prevent Each Spouse from Claiming Insurance Exemptions. *In re Rudd*, 483 B.R. 354 (Bankr. M.D. Ala. 2012)**

Debtors James and Melba Rudd filed a joint voluntary Chapter 7. The trustee objected when the debtors claimed four life insurance policies exempt pursuant to Alabama law. The trustee cited *In re McWhorter*, 312 B.R. 695 (Bankr. N.D. Ala. 2004), for the proposition that the debtors' claimed exemptions do not apply when the owners and beneficiaries of the policies are co-debtors in bankruptcy. However, the court disregarded this argument because *McWhorter* ultimately denied the insurance exemption, not because the debtors filed a joint petition, but because statutory requirements were not satisfied. In *McWhorter*, the exemption required the owner and beneficiary to be the same person and that person must have taken out the policy on the life of his or her spouse. Because the husband's policy in *McWhorter* failed in this statutory requirement, the court disallowed the exemption.

The *Rudd* court identified two issues: whether the exemptions may be used in a joint proceeding when the policy beneficiary is a co-debtor in bankruptcy and, if the answer is yes, what do the exemptions protect and against which creditors?

Pursuant § 302, when a joint case is filed, two separate bankruptcy estates are created. The court characterized these estates as separate and distinct. Because each estate is distinct, the effect of filing a joint petition does not automatically result in substantive consolidation, but rather, permits each debtor to claim his or her entitled exemption as if the case were filed on its own. The filing a joint petition does not nullify the effect of § 522(b)(3) (which allows debtors to exempt certain retirement funds) or the Alabama insurance exemptions, the court held.

After finding that the debtors' claimed exemptions were available to them, the court concluded that because § 302 of the Bankruptcy Code creates two separate estates, the debtors were entitled to claim their rightful exemptions regardless of whether a joint proceeding is filed or whether one of the co-debtors is a policy owner or a beneficiary.

- **Deconsolidation, not Dismissal, is the Proper Remedy for a Joint Petition Filed by Unmarried Debtors. *In re Wilkerson*, 2006 WL 3694638 (Bankr. M.D. Ga. Mar. 29, 2006)**

These debtors had once been married, but were divorced at the time they filed a joint bankruptcy case. Prior to filing, a creditor had financed one of the debtors' purchase of a lot and mobile home. However, the creditor failed to record the security deed until several months after the purchase, and one month prior the bankruptcy filing. After the trustee filed an adversary proceeding to avoid the lien, the creditor moved to dismiss the case because it was improperly filed as a joint case. The trustee sought deconsolidation as an alternative to dismissal.

At the outset, the court held that since the debtors were not married, they clearly could not file a joint case under § 302. Thus, the issue was the appropriate remedy. If the case were dismissed, the court pointed out, the creditor would benefit because her security deed would not be subject to avoidance. However, this would be to the detriment of other creditors who would benefit from the trustee's avoidance action.

The court found both debtors eligible for bankruptcy, but that they simply erred in filing a joint petition. The court compared this situation to the filing of an involuntary petition against spouses – since involuntary petitions may only be brought against "an individual" – and concluded that the better view was that bankruptcy courts have jurisdiction over defective filings, but the defect should be cured through procedural rules. Thus, Federal Rule of Civil Procedure 21, governing misjoinder, applied. That rule provides that "Misjoinder of parties is not ground for dismissal of an action. Parties may be dropped or added by order of the court on motion of any party or of its own initiative at any stage of the action and on such terms as are just. Any claim against a party may be severed and proceeded with separately." Since § 707 provides that a Chapter 7 case cannot be dismissed absent a showing of cause or abuse, and since each debtor filed voluntarily and both were eligible to be debtors, deconsolidation was the proper remedy.

- **Recognition of Same-Sex Couples as "Spouse" Under 11 U.S.C. § 302(a). *In re Simmons*, 584 B.R. 295 (Bankr. N.D. Ill. 2018)**

In *Obergefell v. Hodges*, 135 S.Ct. 2584 (2015), the Supreme Court ruled that marriage is a fundamental right, that same-sex couples must not be deprived of that right, and that States must recognize lawful same-sex marriages performed in other States.

A same-sex couple had obtained a Certificate of Civil Union under the Illinois Religious Freedom Protection and Civil Union Act (RFPCUA) prior to filing their joint Chapter 13 case. The Chapter 13 trustee moved to dismiss because they did not hold a Certificate of Marriage under Illinois Marriage and Dissolution of Marriage Act (as opposed to the Certificate of Civil Union they held).

Because the term "spouse" is not defined in the Bankruptcy Code, and there is no comprehensive federal definition to be found elsewhere, the court held that the term should be given its ordinary meaning. According to the court:

> The dictionaries are uniform in stating that a "spouse" is a "husband," a "wife," or an individual who is "married." A "husband," in turn, is a "married man," a "wife" is a "married woman," and an individual is "married" when they are united in "wedlock," united in the "state of matrimony," or when they have a "husband" or "wife." "Wedlock" in turn means the "state of marriage," state of "matrimony" means "the state of being married," and, as can be inferred from the immediately preceding sentence, one has a "husband" or a "wife" when one is "married" to a man or to a woman, respectively. To determine whether one is a "spouse," then, under the ordinary meaning of that term in the Bankruptcy Code, the court must determine whether one is in the state of marriage with or in the state of being married to another individual.

(citations omitted).

"An individual is in a state of marriage with another person based on the individual's status vis-à-vis the other person under state law," the court held. Under the RFPCUA:

> Protections, obligations, and responsibilities. A party to a civil union is entitled to the same legal obligations, responsibilities, protections, and benefits as are afforded or recognized by the law of Illinois to *spouses*, whether they derive from statute, administrative rule, policy, common law, or any other source of civil or criminal law.

750 Ill. Comp. Stat. 75/20 (emphasis added). The statute also provides that:

> "Party to a civil union" means a person who has established a civil union pursuant to this Act. "Party to a civil union" means, and shall be included in, any definition or use of the terms "spouse", "family", "immediate family", "dependent", "next of kin", and other terms that denote the spousal relationship, as those terms are used throughout the law.

750 Ill. Comp. Stat. 75/10.

The court pointed out that this language is nearly identical to the language in the Marriage and Dissolution of Marriage Act and, therefore, the court concluded that the substantive nature of the debtors' status under Illinois law vis-à-vis one another meant that they were substantively, if not formally, in a state of marriage with one another under Illinois law. Therefore. both are each other's spouses under the Bankruptcy Code. This was true, the court held, even though Illinois had recently prohibited individuals in a civil union to file joint tax returns. Therefore, they were eligible to file a joint Chapter 13 case. ***Contra, In re Allen*, 186 B.R. 769 (Bankr. N.D. Ga. 1995)** (pre-*Obergefell*, a Georgia bankruptcy court held that, although the same-sex couple's relationship was similar to married individuals, state law did not recognize their relationship and, therefore, they were not eligible to file a joint petition).

➢ **Absent Consent, Attorney Representing Wife in Divorce Shall Not Represent Wife and Husband in Joint Bankruptcy Case.** ***Bd. of Attys. Prof'l Responsibility v. Zablocki*** **(*****In re Zablocki*****), 635 N.W.2d 288 (Wis. 2001)**

Prior to this disciplinary proceeding, an attorney's license to practice law was suspended for six months for failing to maintain a client trust account and comingling funds. The subject of this disciplinary proceeding involved the attorney's representation of a couple involved in divorce. The wife retained the attorney to represent her in divorce and, while the divorce was pending, both husband and wife retained the same attorney to represent them in a joint bankruptcy case. The attorney failed to inform the couple of the obvious conflict of interest in this representation and failed to obtain written consent from either party relating to conflicts. In fact, the attorney had encouraged them to retain him and file jointly because it would be less expensive and easier for him to represent them in bankruptcy. Notwithstanding that the attorney was soon to be suspended from practicing law, he filed a Chapter 7 joint bankruptcy case for the couple.

The attorney not only failed to inform the couple that his license was soon to be suspended, but he also failed to notify the bankruptcy trustee and the bankruptcy court of his suspension. The Supreme Court of Wisconsin concluded "by representing the wife in the bankruptcy case when his representation was directly adverse to the husband and when his representation of the wife was materially limited by his responsibility to the husband…", the attorney's conduct violated Wisconsin's Rules of Professional Conduct. Further violations included the attorney's failure to obtain written consent from each party and failing to inform them of his suspension. As a result of the violations, the Supreme Court publicly reprimanded the attorney.

IV.

Special Counsel: Who qualifies as "special counsel" in a bankruptcy case and what am I as debtor's counsel supposed to do?

Section 327(e) of the Bankruptcy Code provides:

> (e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

"The requirements for employment under section 327(e) are less stringent than under section 327(a)," which governs generally the employment of professionals in a bankruptcy case. 3 Collier on Bankruptcy ¶ 327.01[3] (Richard Levin& Henry J. Sommer eds., 16th ed.). "An attorney will qualify for employment under section 327(e) provided the attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed." *Id.* However, "Applications seeking compensation by professionals under section 327(e) are carefully scrutinized to ensure that professionals retained receive compensation only for those services directly related to the limited scope of retention and not for services rendered generally to the trustee in connection with the bankruptcy case."

Federal Rule of Bankruptcy Procedure 2014(a) governs applications for employment of counsel. It states:

> An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.

Materials regarding the employment of special counsel:

- **Richard H. Thomson, *Hiring Debtor's Nonbankruptcy Attorney as Special Counsel*, 34-JUL Am. Bankr. Inst. J. 14 (July 2015);**
- **John C. Hoard, Christopher M. Trapp, *Special Counsel Misgivings: Denial and Disgorgement*, 32-JUN Am. Bankr. Inst. J. 24 (June 2013);**
- **David P. Holtkamp, *The Trustee's Ability to Employ Special Counsel; The History and Application of the Adverse-Interest Standard in § 327*, 30-AUG Am. Bankr. Ins. J. 26 (July/August 2011)**

Selected cases:

➢ ***In re M&M Marketing, L.L.C.*, 397 Fed. Appx. 258 (8th Cir. 2010)**

The trustee in two related involuntary Chapter 7 cases filed applications to approve the employment of an attorney, who was also representing petitioning creditors, as special counsel to represent the trustee in pursuing preferential and fraudulent transfer claims against a creditor. After the applications were approved, the creditor moved to disqualify counsel based on a conflict of interest. The bankruptcy court denied the motion, but the Eighth Circuit BAP reversed. Affirming the BAP's decision, the Eighth Circuit Court of Appeals held that the trustee's attempt to justify the employment by arguing that counsel was employed for a "special purpose" failed because § 327(e) governs special-purpose representation and that statute did not apply because the "special counsel" did not previously represent the debtors, as expressly required by the statute. In addition, the Eighth Circuit held that counsel had an interest adverse to the estates because he was also serving as attorney for several creditors who held interests adverse to the estates.

➢ ***In re Jones*, 2013 WL 1558088 (Bankr. M.D. Ala. April 12, 2013)**

Debtor filed a Chapter 7 case, fully disclosing her interest in a pending personal injury case. She also disclosed that attorney Guy Willis was representing her in the personal injury case. The Chapter 7 trustee attempted to contact Willis with a view to retain him to pursue the claim, but Willis rebuffed him, presumably, the court said, because he didn't want to answer the trustee's questions about the case. Instead, Willis filed his own application to be employed but, because only a trustee may retain counsel to pursue a claim which is property of the estate, the bankruptcy court denied Willis' application. Nevertheless, Willis continued to represent the debtor in the personal injury action and actually settled it, without bankruptcy court authority, for $8,000. Willis apparently used some of this money to pay creditors claiming liens against it, as well as giving some to the debtor. Willis then filed a second application to approve his own employment and pay his attorney fees. The trustee objected and, in fact, filed a motion to require Willis to turn over the $8,000. The court held that, since § 330 only allows compensation to "a professional person employed under section 327," and Willis had not been so employed, he could not be paid. Acknowledging that some courts have allowed nunc pro tunc applications for employment, doing so requires a finding of extraordinary circumstances, which were not present here. Moreover, he was required under § 542 to account for and turn over all the settlement proceeds.

- ***In re Blume*, 591 B.R. 675 (Bankr. E.D. Mich. 2018)**

The debtors in this case filed a motion to hire special counsel to represent them in state court litigation against a creditor and to incur debt, granting special counsel a postpetition lien on their property, to do so. The creditor-defendant objected. The bankruptcy court held that granting the attorney a lien on the debtors' property violated Rule 1.8(j) of the Michigan Rules of Professional Conduct, which prohibits a lawyer from acquiring a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for the client, because the property was part of "the subject matter of" the state court litigation. Specifically, the litigation included a claim that the debtor-wife had transferred the property from herself as the sole owner to herself and her then-husband to prevent the creditor from reaching it. Giving the attorney a lien in that property violated not only the rule, but also public policy, the court held.

However, the court authorized the debtors to hire the special counsel, without the granting of any lien, based on the assumption that the debtors would not be required to pay, and would not pay, the attorney's debt during the pendency of the Chapter 13 case, as part of any Chapter 13 plan or otherwise. Noting a split of authority on the issue of whether Chapter 13 debtors are required to satisfy § 327(e) in order to hire special counsel, the court held that, "at least under the circumstances of this case," § 327(e) and its requirements did not apply. According to the court:

> Cases holding that § 327(e) and its requirements do apply to a Chapter 13 debtor's request for approval to employ special counsel include: *In re Goines*, 465 B.R. 704, 706 (Bankr. N.D. Ga. 2012); *Wright v. Csabi* (*In re Wright*), 578 B.R. 570, 582 (Bankr. S.D. Tex. 2017). Cases holding that § 327(e) and its requirements do *not* apply to a Chapter 13 debtor's request for approval to employ special counsel include: *In re Jones*, 505 B.R. 229, 231 (Bankr. E.D. Wis. 2014); *In re Scott*, 531 B.R. 640, 645 (Bankr. N.D. Miss. 2015); *see also In re Gilliam*, 582 B.R. 459, 465-66 (Bankr. N.D. Ill. 2018) (§ 327 does not apply in Chapter 13 cases); *In re Maldonado*, 483 B.R. 326, 330 (Bankr. N.D. Ill. 2012) (same).

As a result, except for ruling that special counsel could not have a lien on the property, the court denied the motion to employ as unnecessary.

V.

Good and Bad Faith: What does "bad faith" mean in a bankruptcy case and will I know it when I see it?

- **A Chapter 7 Debtor's Prepetition Bad Faith Constitutes "Cause" for Dismissal; Adopting a Totality of the Circumstances Test. *In re Piazza*, 719 F.3d 1253 (11th Cir. 2013)**

In this case, a creditor obtained a prepetition state court judgment against the debtor on a business guarantee. The creditor attempted for two years, without success, to collect on the judgment. As a result, the state court required that the debtor produce documents justifying his failure to pay by a certain date. On the day prior to that deadline, the debtor filed a Chapter 7 case. The creditor moved to have the case dismissed. The bankruptcy court granted the motion, concluding that "cause" existed to dismiss the case pursuant to § 707(a) based on bad faith. The court determined that a finding of bad faith should be guided by a list of 15 nondispositive factors set out in *In re Baird*, 456 B.R. 112 (Bankr. M.D. Fla. 2010).

In affirming, the Eleventh Circuit held, as a matter of first impression, that "cause" to dismiss under § 707(a) includes bad faith. It did not, however, adopt *Baird*'s specifically-enumerated factors, but instead adopted a totality-of-the circumstances analysis. Nevertheless, the Circuit said, the bankruptcy court did not apply an erroneous legal standard because it properly examined the relevant facts of the case, including among many other things, the debtor's prepetition conduct in avoiding paying the judgment, to determine the debtor's "intentions" and whether he was "an honest but unfortunate debtor entitled to a fresh start."

- **By Failing to Raise Bad Faith at Confirmation, Creditor Waived Lack of Good Faith as Basis for Dismissal of Chapter 13 Case. *In re Pfetzer*, 586 B.R. 421 (Bankr. E.D. Ky. 2018)**

Prior to filing Chapter 13, the debtor had been sued by a creditor in state court. After the bankruptcy filing, the creditor filed a $700,000 proof of claim and an adversary proceeding seeking to deny the debtor's discharge under § 727(a). However, it did not object to the debtor's Chapter 13 plan or amended plan by the deadline in which to do so. The day after the creditor stipulated to dismissal of the adversary (because § 727 does not apply in Chapter 13 cases), the creditor moved to dismiss the debtor's case under § 1307(c) for "cause." Noting that bad faith in filing the petition has long been considered cause for dismissal of a Chapter 13 case, the court pointed out that § 1325(a)(7) also provides that a plan cannot be confirmed if the debtor did not file the case in good faith. The court held that, since the creditor failed to meet the deadline to object to confirmation, it was barred from later seeking dismissal for bad faith. If the statutory deadline to assert bad faith is to have any meaning, the court held, then a creditor may not sidestep it by ignoring the "good faith filing" requirement for confirmation and then assert the same time of good faith argument for dismissal for cause.

- **Scheduling Omissions and Filing Deficiencies Support Dismissal for Cause as Bad Faith Filing Under § 1112(b).** ***In re Moore*, 583 B.R. 507 (C.D. Cal. 2018)**

The individual debtor was a broadcaster, producer, and musician who owned multiple businesses in the music industry. In 2015, Wells Fargo had obtained a $7.1 million judgment against him, which allowed Wells Fargo to replevin his intangible property, personal property, royalties, profits, and other collateral. It also allowed Wells Fargo to foreclose on two properties owned by the debtor's business. After the debtor filed a pro se chapter 11 case, he filed an adversary proceeding against Wells Fargo and 18 other individuals and entities, alleging that Wells Fargo had obtained the judgment through fraud, and that the other individuals and entities were depriving him of his property. The United States Trustee moved to dismiss or convert under § 1112(b).

At a hearing, the court announced its "tentative view" to convert, but a creditor, Wells Fargo, asked for dismissal, noting the debtor's litigious history and the risk he would interfere with the Chapter 7 trustee's exercise of his fiduciary duties. Another creditor – the debtor's former romantic partner, who was not notified of the filing – expressed a preference for conversion. Ultimately, the bankruptcy court dismissed the case with a 180-day refiling bar based on the debtor's failure to provide "important documents" in the case, he was unlikely to confirm a plan, and his history of vexatious litigation. The court also found that the debtor had engaged in bad faith by not listing the former partner as a creditor.

The debtor appealed to the district court, which distilled the debtor's numerous arguments into two issues: whether the bankruptcy court abused its discretion in dismissing with the bar to refiling, and whether the court had violated his due process and equal protection rights.

Dismissal of a Chapter 11 under § 1112(b), the court held, requires a two-step analysis: First, it must be determined that "cause" exists to dismiss and second, a choice must be made between conversion and dismissal based on the "best interests of the creditors and the estate." In considering the second prong, the court must consider the interests of *all* of the creditors. Affirming the bankruptcy court's decision, the district court held that bad faith is grounds to dismiss or convert and that a bankruptcy case is filed in bad faith if it was brought for "tactical reasons unrelated to reorganization," which the bankruptcy court did not err in finding. Of particular importance here was that the debtor had filed a dischargeability action against the former partner in her own bankruptcy case, but then did not list her as a creditor in his case. Since the bankruptcy court's conclusions "were neither illogical, implausible, nor unsupported," they had to be affirmed, the district court held. In addition, the debtor had not been discriminated against based on a "protected classification," and the government plainly has a legitimate interest in treating bankruptcy filers differently based on whether they properly submit necessary paperwork, so there was no equal protection violation. And, since the bankruptcy court had given him a hearing, at which he appeared and argued, and issued a written decision explaining its reasoning, there was no due process violation. Note that the debtor has appealed to the Ninth Circuit.

- **Debtor Could Not Be Denied Exemption in Previously Undisclosed Asset on Bad Faith Grounds. *In re Muscato*, 582 B.R. 599 (Bankr. W.D. N.Y. 2018)**

In 1992, the Chapter 7 debtor in this case recorded a deed under which she retained a life estate in her real property, but transferred the remainder interest jointly to her children. Six years later, in 1998, she filed a Chapter 7 case without listing her interest in the life estate or claiming it exempt. Her case was closed later that year. In 2016, the debtor and her children executed a deed which purported to convey the property to a third party. Counsel for the purchaser raised a title objection based on the earlier bankruptcy filing. The debtor then moved to reopen the case in August 2017, and amended her schedules to acknowledge the ownership of the life estate and to claim a homestead exemption in it. The parties agreed that, based on her age when she filed the bankruptcy case, the life estate would have had a value of about $31,000 in 1998. Debtor claimed the maximum $10,000 homestead exemption in it.

The trustee objected, arguing that the debtor had acted in bad faith by not listing the life estate which she clearly knew about at the time. He also argued that the exemption should be denied because creditors had been prejudiced by the lengthy delay. Interpreting *Law v. Siegel*, 571 U.S. 415 (2014), the court allowed the exemption. Disagreeing with courts which have held to the contrary, this court interpreted *Law v. Siegel* to allow debtors to freely amend schedules and claim statutorily-entitled exemptions, even after the case is closed. It also said that the fact that *Law v. Siegel* was an exemption surcharge case, as opposed to an exemption allowance case, was a distinction without consequence. Further, excusable neglect is not necessary to reopen to amend schedules. Since the New York exemption law did not include language which might compel disallowance of the exemption, it had to be allowed. The court noted, however, that in some "unusual circumstances," where, for example, the property had lost value over the years, there might be some argument for disallowance. However, the trustee had not made any such argument in this case.