Bankruptcy Bulletin
A Publication of the Minnesota State Bar Association Bankruptcy Section

February 2006

Editors-In-Chief:

David B. Galle
Oppenheimer Wolff & Donnelly LLP
Plaza VII, Suite 3300
45 South Seventh Street
Minneapolis, MN 55402-1609
612-607-7572
dgalle@oppenheimer.com

Laurie K. Jones
Faegre & Benson LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402-3901
612-766-8381
ljones@faegre.com

Andrew P. Moratzka
Mackall, Crounse & Moore, PLC
1400 AT&T Tower
901 Marquette Avenue
Minneapolis, MN 55402
612-305-1418
apm@mcmlaw.com

Editorial Board:

Ellen Cha
Rider Bennett
612-340-7962
echa@riderlaw.com

Troy Gunderman
Educational Credit Management Corporation
651-221-0566
tgunderman@ecmc.org

Gary D. Kanwischer
Wells Fargo & Company
612-667-2407
gary.d.kanwischer@wellsfargo.com

Marie F. Martin
Hoglund, Chwialkowski, Greeman & Bergmanis
651-628-9929
mfmartin@hoglundlaw.com

Henry T. Wang
Gray, Plant, Mooty, Mooty & Bennett, P.A.
612-632-3370
henry.wang@gpmlaw.com

IN THIS ISSUE

Bankruptcy Appellate Panel Finds Failure To Disclose Diamond Ring In Bankruptcy Schedules Not Indicative Of Fraudulent Intent

Debtor's Status As A Farmer Is An Affirmative Defense That Can Be Waived If Not Timely Asserted

Bankruptcy Appellate Panel Upholds Sanctions Award for Violating Discharge Injunction

Court Continues to Adhere to the Clear Language of the Code's Credit Counseling Requirements

Failure to Follow the Code's Procedural Requirements May Result in Dismissal of Bankruptcy Case

Automatic Stay Not Continued Pursuant to 362(c)(3)(B) for Failure to Give Appropriate Notice

Post-Petition Profits From Pre-Petition Agreement Should Be Paid As Administrative Expenses

Failure To Hold Hearing Before Approving Settlement Stipulation Results In Remand

Payday Lender May Negotiate Post-Dated Checks Prior To Debtor's Discharge

ANNOUNCEMENTS

CARE Program

Available Positions at the U.S. Trustee's office

Bankruptcy Appellate Panel Finds Failure To Disclose Diamond Ring In Bankruptcy Schedules Not Indicative Of Fraudulent Intent

In *Ellsworth v. Bauder, (In re Bauder)*, No. 05-6033 (B.A.P. 8th Cir. 2005), the Eighth Circuit Bankruptcy Appellate Panel (the "BAP") reversed the bankruptcy court's determination that Bauder (the "Debtor") had knowingly and fraudulently made a false oath or account under 11 U.S.C. § 727(a)(4)(A). The Debtor filed for bankruptcy but failed to list some personal property including a diamond ring that was in the possession of her daughter. Nine days after her 341 meeting, the Debtor amended her schedules to list the diamond ring and assigned its value at $300.

The Debtor's former boyfriend ("Plaintiff") filed an adversary proceeding seeking to deny her discharge because she failed to list all of her personal property, including the diamond ring. The Plaintiff had given the diamond ring to the Debtor, which he bought for approximately $1,000. The Debtor did not dispute that Plaintiff had purchased the ring for that amount. The Debtor explained at the trial that she failed to disclose the ring because it was in the possession of her daughter. The Debtor claims that someone at her attorney's office told her that she only had to disclose items that were in her possession. Additionally, she testified that the ring was only worth $300 and that it had fallen into disrepair and a pawn shop only offered to pay her $3 or $4 for it. Other than the diamond ring, the Debtor admitted to the bankruptcy court that she failed to list some of her other property because they were valueless. The District Court denied her discharge under 11 U.S.C. § 727(a)(4)(A) based solely on her failure to disclose the diamond ring on her schedules (although it did express concern regarding what it interpreted as an improper attempt by the Debtor to conceal certain assets by alleging they were valueless).

The BAP noted that the trial court should be given "due regard" to determinations of credibility, however, after reviewing the record as a whole, the Court was left with a distinct impression that the trial court had committed clear error. The BAP believed that the trial court confused the Debtor's testimony about valueless property and the diamond ring. While the Debtor gave a couple of reasons for not originally disclosing the diamond ring, the BAP did not find those reasons to be contradictory as did the trial court. The BAP did not find that the Debtor had fraudulent intent when she failed to disclose her diamond ring. She voluntarily amended her schedules shortly after her 341 meeting. Finally, the Court compared favorably the Debtor's failure to disclose with a recent case (*In re Bren*, 122 Fed. Appx. at 289) in which a different debtor failed to disclose her interest in a "modest" inheritance, and stated "if Mrs. Bren qualifies for a discharge, then … [the Debtor] who omits but then timely discloses a worthless ring from her schedules certainly should."

In a dissenting opinion, Judge Schermer noted that the value of the property which was not disclosed should not be determinative of whether a debtor's failure to disclose was material. He stated that debtors receive a great benefit from having their debts discharged and in exchange the debtors must pay for it with honesty and candor. Judge Schermer would have upheld the bankruptcy court decision because he believes that factual determinations are not to be reviewed de novo when the reviewing court would have decided the case differently. He felt that as long as there was a reasonable basis to conclude the way the trial court concluded, its decision must stand.

Debtor's Status As A Farmer Is An Affirmative Defense That Can Be Waived If Not Timely Asserted

In *Marlar v. Williams, (In re Marlar)*, No. 05-2015 (8th Cir. 2005), the Eighth Circuit Court of Appeals held that a debtor's status as farmer is an affirmative defense that can be waived if not timely asserted by the debtor. In 1998, petitioning creditors filed an involuntary bankruptcy against Marlar (the "Debtor"); he was adjudicated to be a debtor and an order for relief was entered. Five years later, the Debtor asserted that he was a farmer and was therefore excepted from being forced into an involuntary bankruptcy. The bankruptcy court and district court both held that the Debtor's status as a farmer was an affirmative defense that could be waived if not timely asserted.

Before the Eighth Circuit, the Debtor argued that 11 U.S.C. § 303(a) deprived the bankruptcy court of subject matter jurisdiction because "farmers" were excluded from the list of entities which could be the subject of an involuntary bankruptcy. The Eighth Circuit rejected the Debtor's interpretation of § 303(a) because it could not be reconciled with § 303(h) which states that "[i]f the petition is not timely controverted, the court shall order relief against the debtor…". The Eighth Circuit stated that if bankruptcy courts were not given subject matter jurisdiction over cases allegedly involving farmers or other excepted entities, uncertainty would arise in the bankruptcy process each time one of these entities was involved in an involuntary bankruptcy. To further support its decision that a debtor's status as a farmer is an affirmative defense, the Eighth Circuit noted that a debtor's status as a farmer should not be treated like an "ultimate trump card" that could be raised at any time during an involuntary bankruptcy case to strip the court of subject matter jurisdiction.

After the Eighth Circuit decided that a debtor's status as a farmer was an affirmative defense, it quickly concluded that a five year delay in raising such a defense was untimely.

Bankruptcy Appellate Panel Upholds Sanctions Award For Violating Discharge Injunction

In *Sabala v. Hanson (In re Sabala), No. 05-6029* (BAP 8th Cir. 2005), the Bankruptcy Appellate Panel for the Eighth Circuit ("BAP") upheld the bankruptcy court's award for sanctions against creditor Gerald Hanson ("Hanson") for violating the discharge injunction.

Annette Sabala (the "Debtor") filed for Chapter 7 bankruptcy, listing Hanson as the holder of a contingent, unliquidated, unsecured non-priority claim. Hanson filed a complaint to determine the dischargeability of his claim, which was dismissed by order. The bankruptcy court subsequently entered an order discharging the Debtor and closed the case. Thereafter, Hanson filed a second complaint to determine the dischargeability of the claim. The bankruptcy court held a hearing and issued an order dismissing Hanson's second complaint. The Debtor filed a motion for sanctions and after a hearing, the bankruptcy court determined that Hanson had violated the discharge injunction and sanctions were warranted. Hanson filed a motion to reconsider, which he later withdrew and filed this appeal which presented two primary issues.

The first issue raised was whether Hanson's appeal was timely. Federal Rule of Bankruptcy Procedure 8002(a) requires a notice of appeal to be filed within 10 days of the entry of the order appealed from. In addressing the issue, the BAP first noted that a motion for reconsideration tolls the time to

appeal under Federal Rule of Bankruptcy Procedure 8002(b), which continues until the motion is disposed of or withdrawn. The BAP found that because Hanson filed his notice of appeal within 10 days after withdrawing the motion to reconsider, the appeal was timely.

The second issue considered whether the bankruptcy court properly imposed monetary sanctions on Hanson. The BAP concluded that the bankruptcy court did not abuse its discretion in awarding sanctions on two bases. First, Hanson was given ample opportunity to address the possibility of sanctions. He was put on verbal notice during a hearing prior to the motion for sanctions and at the hearing on the motion for sanctions, Hanson was given an opportunity to present evidence and argument. Second, the Bankruptcy Court's sanctions award was warranted. It took into account Hanson's pro se status and carefully limited the award to sufficiently reimburse the Debtor for her fees and travel costs incurred as a result of Hanson's second complaint.

Court Continues to Adhere to the Clear Language of the Code's Credit Counseling Requirements

Before the court in *In re Brenda Lee Wallert*, Bky. Case No. 05-90789 (Bankr. D. Minn. November 17, 2005) was whether the debtor's "Certificate Requesting Exemption from Credit Counseling Briefing" (the "Certificate") filed with the court met the requirements set forth in 11 U.S.C. § 109(h). Addressing both the procedural and substantive defects of the Certificate, the court held that the debtor was not eligible to be a debtor under the bankruptcy code and that cause therefore existed to dismiss the debtor's case.

Under 11 U.S.C. § 109(h)(1), a debtor is required to both obtain counseling services from an approved credit counseling agency during the 180 days preceding the filing of a bankruptcy petition and file a certificate received from the counseling agency along with the petition. 11 U.S.C. § 521(b)(1). Here, the debtor filed for chapter 13 bankruptcy relief on November 2, 2005 in order to stop a foreclosure sale of her homestead. By a separate document, the debtor filed the Certificate requesting an exemption from receiving credit counseling prior to the filing of the bankruptcy petition. The Certificate stated she was advised by her attorney on November 2, 2005, to obtain credit counseling; she was advised by one agency that she could not obtain credit counseling on such short notice; and she would have to pay a $50.00 processing free to another credit agency. According to the Certificate, the debtor determined that "it was not possible to get credit counseling immediately" and she filed the petition because the foreclosure sale of her homestead was imminent.

11 U.S.C. § 109(h) exempts a debtor from the requirement of credit counseling before a bankruptcy filing, on "certain very narrow and specific grounds." The bankruptcy code requires the debtor to set forth in their certification three elements in order to be excused from credit counseling. First, the debtor must set forth "exigent circumstances" to merit a waiver of the requirement. 11 U.S.C. § 109(h)(3)(i). Second, the debtor must actually try to obtain counseling service and demonstrate that he or she was unable to do so within five days of making the request. 11 U.S.C. § 109(h)(3)(ii). Finally, the debtor's certificate and reasons for not obtaining credit counseling must be satisfactory to the court. 11 U.S.C. § 109(h)(3)(iii). Here, the Certificate failed under the second element. Attempting to obtain credit counseling service the day before a foreclosure sale was not a satisfactory attempt.

Failure to Follow the Code's Procedural Requirements May Result in Dismissal of Bankruptcy Case

In *Ruesch v. Household Automotive Finance Corporatio*n, Bky. Case No. 05-6022 (8th Cir. B.A.P. December 5, 2005), debtors challenged the bankruptcy court's order denying their Motion to Vacate Order Granting Relief From Stay and Prohibiting Debtors From Filing for 180 days and to Reinstate Case.

Debtors filed the current chapter 13 case on February 9, 2005, their fifth chapter 13 case over a 13-month period. On February 29, 2005, Household Automotive Finance Corporation ("Household") filed a motion to dismiss or in the alternative for relief from the stay. Part of Household's proposed order sought to prohibit debtors from filing a new petition for 180 days in the event of a dismissal. Debtors failed to submit a response to Household's motion and did not appear for the hearing. On March 31, 2005, due to debtors' failure to cure various deficiencies in their filings, the court dismissed their case. The court order also barred the debtors from re-filing for 180 days.

By way of motion, debtors asked the bankruptcy court to vacate the order granting Household relief from the stay and asked that their case be reinstated. Citing to Rule 52 and 59 of the Federal Rules of Civil procedure, the court first noted that the debtors did not timely appeal the dismissal order. With respect to the order granting relief from stay, the court stated the order granting relief from stay, and any appeal therefrom, was rendered moot by the dismissal of the debtors' case. The court went on to find that the bankruptcy court did not abuse its discretion in granting relief from stay because the debtors did not submit any evidence demonstrating excusable neglect for failing to respond to Household's motion for relief from stay.

Automatic Stay Not Continued Pursuant to 362(c)(3)(B) for Failure to Give Appropriate Notice

In *In re Collins*, No. 05-39711 (Bankry. D.Minn), the Bankruptcy Court held that the Debtor's motion to continue the automatic stay beyond 30 days after the order for relief was entered should be denied for lack of notice. Under a new section of the Bankruptcy Code, the automatic stay terminates by operation of law on the thirtieth day after a debtor petitions for relief if that debtor had been a debtor within the preceding one-year period. 11 U.S.C. § 362 (c)(3). The bankruptcy court may extend this thirty-day period if the debtor or other party in interest demonstrates, after notice and hearing before the expiration of the thirty-day period, the second case was filed in good faith. *Id*.

Here, the debtor had been a debtor in a case that was pending during the one year prior to the commencement of the current case. Although the debtor moved to extend the thirty-day deadline, creditors were not served with that motion. Based on lack of notice, the court did denied the debtor's request without reaching the merits of the motion.

The debtor in *In re Collins* tried again. The motion was decided in conjunction with *In re Taylor*, No. 05-90793, because both motions suffered the same defect. In theses motions, the debtors both served the motion on all the creditors listed in their respective schedules. But the mailing of the motions five days in advance of the hearing (as in Taylor) or eight days in advance of the hearing (as in Collins) was not sufficiently in advance of the hearing to satisfy the due process requirements the

Supreme Court established in *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950), which requires notice to be "reasonably calculated. . . to apprise interested parties of the pendency of the [motion] and to afford them an opportunity to present their objections." Perhaps more importantly, Local Rule 9006-1(a), which requires motions to be filed and served ten days before the hearing date, or mailed not later than fourteen days before the hearing date, was violated. The motions were thus denied.

Post-Petition Profits From Pre-Petition Agreement Should Be Paid As Administrative Expenses

In the case of *Hallmark & Associates v. Athens/Alfa Gas Corporation*, B.A.P. 8th Cir., No. 05-6020 ND, 11/4/05, The United States Bankruptcy Appellate Panel for the 8th Circuit held that the co-owners of a well with a debtor, who, under a pre-petition agreement, divided income and expenses with the debtor based on their interest in the well, were entitled to administrative expense priority under Bankruptcy Code Section 503(b)(1)(A) for their share of post-petition gross revenues realized by the debtor.

The debtor operated and owned 50% of the working interest in an oil and gas well in North Dakota. The appellants owned approximately 45% of the wells working interest. Income and expenses were divided between the parties based on these percentages. After the debtor filed its petition, the well turned a $1,000,000 profit, which the debtor used to pay its operating expenses and debts unrelated to the well instead of paying the appellants their share. The appellants sought an allowance for administrative expenses under Section 503(b)(1)(A) for their share of the post-petition gross revenues. The debtor asserted a right to a contractual penalty which offset most of the claim.

The Bankruptcy Court ruled that the appellants did not have an administrative expense claim because there were no post-petition transactions from which the debt arose. The Bankruptcy Appellate Panel reversed finding that the transaction in this case was the debtors post-petition act of "exercising control of all the profits thereby deriving the appellants of their revenue." The debtor actions unwittingly forced the appellants to make a post-petition investment in the business to keep it operating.

Citing *In re Tama Beef Packing, Inc.*, 290 B.R. 90, 96 (B.A.P. 8th Cir. 2003), the Bankruptcy Appellate Panel also noted that the appellants must show that the expenditure provided a tangible benefit to the estate. In this case, the debtor retained the funds and used at least some of the money to pay operating expenses to keep the business viable, which constituted an "involuntary infusion of cash by the appellants which permitted the debtor to maintain operations and therefore indirectly benefited all creditors." Because the Bankruptcy Court came to a contrary conclusion based on an erroneous application of law to the facts, the Bankruptcy Appellate Panel reversed.

Failure To Hold Hearing Before Approving Settlement Stipulation Results In Remand

The U.S. Bankruptcy Appellate Panel for the 8th Circuit in *PW Enterprises, Inc. v. Kaler (In Re: Racing Services, Inc.)*, B.A.P. 8th Cir., No. 05-6038 ND, 11/9/05, held that a bankruptcy court abused its discretion and it approved a stipulation between the chapter 7 trustee and United

States Government without holding a hearing for objecting parties to attend.

Racing Services, Inc. ("RSI") and its chief executive officer and sole shareholder, Susan Bala ("Bala"), were indicted for money laundering and conducting an illegal gambling operation and filed chapter 11, which was subsequently converted to chapter 7. Bala and RSI were convicted and the government was awarded a forfeiture judgment against them in the amount of $99,013,200. The trustee stipulated with the United States that the "parties have agreed that the bankruptcy estate shall remain for distribution to creditors other than the United States by virtue of the forfeiture judgment, the assets of the bankruptcy estate has been actively pursuing."

PW Enterprises, Inc. ("PW") objected to the stipulation. The Bankruptcy Court approved the stipulation and PW appealed, asserting that it had a right to a hearing because it had made a timely request for a hearing when it objected to the trustee's motion. The Bankruptcy Court denied PW's motion for stay pending appeal, however, the B.A.P. granted the stay. Judge Kressel stated that the court's local rules indicate that a hearing will be scheduled if objections to a motion are filed. Kressel further stated that although there was a general order in the case regarding scheduling of hearings, which the trustee argued indicates that a hearing will be scheduled on a motion, only if the opposing party specifically requests one, that nothing in the record indicated PW received notice of this general order.

Kressel noted that the Bankruptcy Court may approve a settlement on a motion by the trustee after notice and a hearing pursuant to Rule 9019(a). A decision to approve or disapprove a settlement under Rule 9019 is within the discretion of the bankruptcy judge. In exercising its discretion, the Bankruptcy Court must consider four factors bearing on the settlements reasonableness. Those factors are (1) the probability of success in litigation; (2) the difficulties, if any, to be encountered in the matter of collection; (3) the complexity of the litigation involved and expense, inconvenience and delay necessitated attending it; and (4) the paramount interest of the creditors and a proper deference to their reasonable views in the premises.

Judge Kressel said "When considering reasonableness, there is no best compromise, only a range of reasonable compromises. So long as the one before the court falls within that range, it may be approved. An abuse of discretion occurs when a bankruptcy court does not weigh these factors and then approves or rejects the proposed settlement."

Here, the Bankruptcy Court did not make any findings of fact, nor did it otherwise articulate a legal basis for its order. Rather, the Judge said, the Bankruptcy Court stated that PW's argument against approval of the settlement was without merit and that approval was in the best interests of the bankruptcy estate. Kressel said the Bankruptcy Court did not have any evidence from which it could determine reasonableness under the criteria. Based on the failure of the Bankruptcy Court to make findings of fact, the court reversed the Bankruptcy Court's order and remanded the case.

Payday Lender May Negotiate Post-Dated Checks Prior To Debtor's Discharge

The 8th Circuit Court of Appeals concluded in *Thomas v. Money Mart Financial Services, Inc. (In Re: Thomas)*, 8th Cir., No. 05-1176, 11/4/05, that a Missouri debtor who had not yet received her chapter

7 discharge had no defense to enforcement when a payday lender cashed four post-dated checks she had written.

On November 15, 2003, Quyita Thomas ("Thomas") obtained four $50 payday loans from Money Mart Financial Services, Inc ("Money Mart"). For each check, she wrote a separate check for $77, which she post-dated to December 15, 2003.

On November 18, 2003, Thomas filed a chapter 7 petition. On December 17, 2003, Money Mart cashed the four post-dated checks. Thomas filed an adversary complaint against Money Mart for violation of the automatic stay. Money Mart argued that its presentment of the checks is excepted from the stay pursuant to Section 362(b)(11) of the Bankruptcy Code. The Bankruptcy Court sided with Money Mart and Thomas appealed.

The Bankruptcy Code provides certain exceptions to the automatic stay, including for "the presentment of a negotiable instrument and the giving of notice of and protesting dishonor of such an instrument." 11 U.S.C. § 362(b)(11). The debtor argued that under Missouri Revised Statutes Section 400.3-305(a)(1)(iv), a negotiable instrument is unenforceable against the obligor with the defense of discharge in bankruptcy proceedings. As a chapter 7 debtor, she claims she could assert the defense of discharge even though at the time of presentment she had not received her discharge. In making this argument the debtor relied on *Hines v. Gordon (In Re: Hines)*, 198 B.R. 769 (B.A.P. 9th Cir. 1996) rev'd on other grounds, 147 F.3d 1185 (9th Cir. 1998).

In *Hines* the 9th Circuit applied a California statute nearly identical to the Missouri statute at issue here. The 9th Circuit summarily concluded that a creditor was not entitled under state law to enforce an instrument against an obligor in bankruptcy, even though the Bankruptcy Court had not yet ordered the discharge of the obligor.

In rejecting *Hines*, the 8th Circuit said "a plain reading of the Missouri statute shows that it, like the California statute, requires the obligor to have received the discharge – not merely to have the possibility of receiving a discharge in the future. Discharge is a specific occurrence in a bankruptcy case, effected by court order, and not guarantied merely by the filing of a petition for relief." In other words, the 8th Circuit would not read "discharge" to mean "future, potential discharge." The Bankruptcy Court's decision was affirmed.

ANOUNCEMENTS:

CARE Program (education in bankruptcy and personal credit responsibility for high school students): The Section, together with the Judges, are forming a committee to develop, propose presentations, and present educational programs at area high schools. Judge O'Brien will act as the judicial member on the committee. Anyone interested in being on the committee or in being a speaker should contact Nauni Manty at nmanty@riderlaw.com.

Available Positions:

TRIAL ATTORNEY
U.S. DEPARTMENT OF JUSTICE
MINNEAPOLIS, MINNESOTA
$77,288 - $139,548

The United States Trustee Program, a component of the Department of Justice, is recruiting for a full-time, excepted service attorney position in Minneapolis, MN. Incumbent would assist in supervising the administration of cases and trustees in cases filed under chapters 7, 11, 12, and 13 of the

Bankruptcy Code and be primarily responsible for the preparation, presentation and litigation of cases arising under the Bankruptcy Code, including the provisions of the Bankruptcy Abuse Protection and Consumer Protection Act of 2005. For additional information, qualification requirements, and application procedures, go to www.usajobs.opm.gov, ref: vacancy announcement # MN-06-001 or call OPM's automated telephone system at 703-724-1850 or TDD at 478-744-2299. An EO/Reasonable Accommodation Employer.

PARALEGAL SPECIALIST
U.S. DEPARTMENT OF JUSTICE
MINNEAPOLIS, MINNESOTA
$36,611 - $70,443

The United States Trustee Program, a component of the Department of Justice, is recruiting for a full-time, excepted service Paralegal position in Minneapolis, MN. Incumbent is responsible for performing a variety of duties that require the application of legal knowledge and financial analysis skills to the examination and processing of cases initiated under the U.S. Bankruptcy Code and are directly in support of the United States Trustee. For additional information, qualification requirements, and application procedures, go to www.usajobs.opm.gov, ref: vacancy announcement # MN-06-002 or call OPM's automated telephone system at 703-724-1850 or TDD at 478-744-2299. An EO/Reasonable Accommodation Employer.