Disclosure Statement

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The Chair's Comments

Dear Members of the Bankruptcy Section:

It is hard for me to believe that my term as Chair is beginning. It seems like only yesterday that I was a college student at UNC Chapel Hill, and my father, Bob Gourley Sr., was the Chair of the Section. Now, with my own son at Chapel Hill, I am following in Dad's footsteps. Time flies.

I remember attending my first Council meeting at the Institute that year in Raleigh. The Council dinner was a very small event, and the annual meeting attendance was far below what we see today. Times change. Today, I see many new faces and fewer of the old, and with the Council, and with the Institute, our numbers are much greater than the past.

As a profession, we are also at a much different place than we were in the late 1980s. The laws are far more intricate, and it is more difficult to competently represent clients in light of BAPCPA. Business cases are more complex, and consumer cases are much more involved. We have seen the number of bankruptcy attorneys increase markedly in the last decade, only to see a dramatic slow-down in bankruptcy filings more recently. This creates new challenges. As professionals who must also run businesses, we have new challenges and stresses that come from the last decade of legal and economic change. Section membership has declined recently partially because the decrease in bankruptcy filings has led attorneys to focus on other practice areas.

Our Section needs to continue to address these challenges and changes. As the new Chair of the Section, I hope to continue the Section's tradition of responding to the needs of our members. First, we need to continue our tradition of informative and timely CLE. We have a wonderful seminar in November, and I am pleased to see how well Andy Tarr and his committee are assembling the program. We need to bring in new members as speakers while also need to continuing to tap our existing resources.

Continued on page 2

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Fourth Circuit Re-establishes Subcontractors' Right to Perfect Liens After Bankruptcy Filing

By Richard A. Prosser and Christopher H. Roede

The Fourth Circuit Court of Appeals recently ruled in the case **In re Construction Supervision Services, No. 13-1560** (May 22, 2014) that the property interest underlying a subcontractor's lien on funds arises from the date of first furnishing labor or materials to a construction project. The timing of when an interest in property arises is critical as it could allow, as it did here, a subcontractor to prime a lender's perfected lien on accounts receivable when notice is not served until after the debtor files bankruptcy. This article briefly describes the decision's impact on the construction industry and the effect on a string of recent North Carolina bankruptcy cases.

Continued on page 3

Inside this Issue...

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The Chair's Comments, continued from the front page

Second, we need to keep serving as a resource for members through our committees and publications. This publication is one example, and I am proud of the work that this committee performs – Oliver Carter, Ben Waller, J.P. Cournoyer, and the other contributors have done a wonderful job. As a purely volunteer group, it is remarkable that they produce such a quality newsletter. Please be sure to offer them your assistance, and please forward topics and articles to them for inclusion in the newsletter.

Finally, I want to help the Section adjust to the new economic realities. Business has declined for many members, and we need to help the membership see value in belonging to the NCBA and to this Section. By continuing our tradition of being responsive to member needs, we can justify the investment of time and resources by our members. For example, we should continue to develop the online component of our member services, including expanded use of social media. I look forward to engaging in this discussion during the course of this year.

I look forward to working with the Section and am honored to be able to serve you this year. Please feel free to contact me with any thoughts, questions, or suggestions.

—Bob Gourley Jr.

Robert F. Gourley Jr. practices with Gourley & Griffin, P.A., in Statesville and Mooresville. He represents clients in Ch. 7 and Ch. 13 cases and also handles a variety of financial matters. Bob received his J.D. from Chapel Hill in 1992 after attending college there as a Morehead Scholar.

Announcement

George Sanderson and his colleagues at Ellis & Winters have started a new blog: What's Fair? A Blog on the Law of Unfair and Deceptive Trade Practices.

Almost every business dispute or consumer dispute in North Carolina includes a claim for unfair or deceptive trade practices. Increasingly, those claims are being litigated in the debtor/creditor context in bankruptcy court. They plan to give the law in this area the focused discussion that it deserves.

Below is a link to the blog post that they published in July that discusses the recent decision in the Southern District of New York Bankruptcy Court's decision on mortgage servicing in the In re Residential Capital bankruptcy: ***http://www.unfairtradepracticesnc.com/res-cap/***

They invite you to visit the blog, to subscribe, and to comment. Also, please let them know if you have any ideas for topics they should cover.

Fourth Circuit, continued from the front page

The automatic stay of Section 362(a)(4) of the Bankruptcy Code generally prevents creditors from taking "any act to create, perfect, or enforce any lien against property of the estate" after the petition date. Section 362(b)(3), however, provides a limited exception to the stay for "any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b)…." Section 546(b), in turn, subjects the bankruptcy trustee's rights and powers to generally applicable laws that "permit perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection…." Coupled together, Section 362(b)(3) and Section 546(b) allow creditors to perfect lien rights post-petition without violating the automatic stay if those rights constitute an "interest in property" at the time the petition is filed.

In **Construction Supervision Services**, a number of subcontractors asserted their entitlement to a lien on funds under the automatic stay exception. The subcontractors typically delivered materials to the debtor, a general contractor, on an open account, later invoicing the debtor for amounts owed. When the debtor filed bankruptcy, the subcontractors sought to serve notice of, and thereby perfect, their lien rights post-petition. This included perfection of liens on funds owing to the debtor on its various projects. The debtor's primary lender, which maintained a perfected security interest in the debtor's receivables, objected to the subcontractors' post-petition notice and perfection. The lender argued that the automatic stay exception did not apply to the subcontractors because their unperfected lien rights did not constitute an "interest in property" as of the petition date. The subcontractors argued that their inchoate lien rights did, in fact, constitute an interest as of the petition date that was subject to the automatic stay exception.

In rejecting the lender's arguments, Judge Wynn, writing for the Fourth Circuit, considered recent changes to North Carolina's construction lien laws and, specifically, N.C.G.S. § 44A-18, which provides for a subcontractor's lien on funds. Specifically, the court considered a clarifying amendment enacted in 2012 to address the precise issue before the court. Consistent with the subcontractors' argument, the 2012 amendment provides that a lien arises and becomes an interest in property contemporaneous with the claimant's first furnishing of labor or materials to a construction project. The 2012 amendment did not control in **Construction Supervision Services** because it post-dated the claims at issue, but the court nonetheless considered it instructive in determining what the legislature originally intended.

The Fourth Circuit's ruling revives the commonly-accepted practice in North Carolina of subcontractors perfecting their lien rights post-petition. This method was standard until a line of bankruptcy court decisions from the Eastern District of North Carolina, **In re Shearin Family Investments, LLC**, No. 08-07082-8-JRL (Bankr. E.D.N.C. April 17, 2009), **In re Mammoth Grading, Inc.**, No. 09-01286-8-ATS (Bankr. E.D.N.C. July 31, 2009) and **In re Harrelson Utilities, Inc.**, No. 09-02815-8-ATS (Bankr. E.D.N.C. July 30, 2009), held that the lien rights of subcontractors could not be perfected once a bankruptcy petition was filed because no pre-petition interest in property existed. The Fourth Circuit concluded that this line of Eastern District bankruptcy cases misinterpreted the law by conflating the lien with the underlying interest it secures, which led the North Carolina legislature to enact the clarifying amendment in 2012.

The Fourth Circuit's decision, in conjunction with the legislature's amendment to N.C.G.S. § 44A-18, provides some clarity to this area of much recent litigation. Subcontractors can confidently return to North Carolina's prior practice of perfecting their lien rights post-petition. This eliminates the concern of many in the construction industry that obstructing this practice would result in increased lien filings as subcontractors rushed to perfect their lien rights at the first sign of financial stress, fearing an imminent bankruptcy and corresponding loss of lien rights.

For lenders, this decision highlights an area of risk in relying on accounts receivable to secure financing to borrowers in the construction industry. Under North Carolina law, a subcontractor's perfected lien on funds has priority over any other lien, including a lender's prior perfected security interest in a contractor's accounts receivable. *See* N.C.G.S.§ 44A-22; **Queensboro Steel Corp. v. East Coast Machine & Iron Works, Inc.**, 82 N.C. App. 182 (1986). Additionally, subcontractors perfecting a claim of lien on funds *only* are not required to file their liens publicly. Lenders providing financing to construction contractors should underwrite their loans accordingly, taking into account the potential for a subcontractor's lien on funds to prime the lender's perfected lien on the contractor's accounts receivable.

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Getting Paid and Staying Paid: How to Avoid Disgorgement/Sanctions

By Brian Behr

The attorney fee disclosure requirements contained in the Bankruptcy Code and the Bankruptcy Rules are relatively straightforward; however, failure to comply with these requirements can result in serious consequences for debtor's counsel.

Prepetition Compensation Disclosure Requirements

Bankruptcy Code Section 329(a) and Bankruptcy Rule 2016(b) together provide that attorneys representing debtors in connection with a bankruptcy case must, within 14 days after a case is filed, file with the court and serve on the Bankruptcy Administrator a statement disclosing the "compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition." Section 329(a) also requires that the source of the compensation be disclosed. Accordingly, if a third party pays any portion of the attorney fees, the payment and the source of payment must be included in the fee disclosure. Rule 2016(b) further requires attorneys to disclose whether they have agreed to share their compensation with any other entity, but does not require disclosure of the details of any agreement for the sharing of compensation with a member or regular associate of the attorney's law firm.

Postpetition Compensation Disclosure Requirements

Rule 2016(b) requires that a supplemental statement complying with Section 329 and Rule 2016 must be filed with the court and a copy transmitted to the Bankruptcy Administrator within 14 days after any payment or agreement not previously disclosed. The supplemental disclosure requirement commences with the filing of a case under any chapter and ceases upon the closure of the case. The requirement also includes the disclosure of compensation received in relation to representing a debtor in an adversary proceeding.

Consequences of Non-Compliance

Because the attorney fee disclosure requirements are viewed as vitally important to the protection of debtors and the bankruptcy process, any attorney who fails to make a full, accurate, and timely fee disclosure, as required by the Code and Rules, runs the risk that the bankruptcy court will order disgorgement of the entire fee received in the case.

In recognition of the importance of accurate and timely fee disclosures, even a negligent or inadvertent non-disclosure may result in denial of all fees. "[S]trict enforcement and adherence to the provisions of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure governing compensation of attorneys and other professionals is necessary to protect the integrity of the bankruptcy system;" as a result, the court may order disgorgement regardless of whether any harm has been done to the estate as a result of the non-disclosure. *In re Tosh*, 2013 Bankr. LEXIS 2370 *8-9 (Bankr. E.D.N.C. June 11, 2013) ("counsel's violations of the disclosure requirements imposed by the Bankruptcy Code and Fed. R. Bankr. P. 2016(b) are sufficient to support denial of compensation, regardless of whether the omissions are materially adverse to the interests of the debtor's bankruptcy estate").

The risks associated with inadequate fee disclosure are so great that debtors' attorneys should take great care to ensure that they fully comply with the requirements of 11 U.S.C. §§ 329, 330 and Rule 2016 by clearly and unambiguously disclosing all fees received and all agreements for the payment of fees in every instance. If doubt ever arises as to whether a fee or fee agreement should be disclosed, that doubt should always be resolved in favor of disclosure.

If a fee agreement includes a limitation on the scope of representation, that limitation should be clearly spelled out in the fee disclosure. Moreover, counsel in the Eastern District should be certain that any limitation of representation complies with E.D.N.C. Local Bankruptcy Rule 9011-1, which governs the scope of a debtor's attorney's duties.

One of the most common fee disclosure mistakes is the failure to file an amended disclosure when additional fees are received from a debtor after the filing of the initial fee disclosure. Even if the initial fee disclosure sets forth the rates for certain post-petition work (e.g., defending motions to lift the stay), once that work is performed and an additional fee is collected, that fee must be disclosed in an amended fee disclosure statement. The failure to file amended compensation disclosures and seek approval of fees, if required, can lead to significant sanctions. For instance, in *In re Daniels*, 2010 Bankr. LEXIS 785 (Bankr. E.D.N.C. March 12, 2010), the court found counsel had irregular billing practices and procedures. Counsel often led clients to believe they would be charged the standard base fee for Chapter 13s and later informed them that additional monies were required for services rendered. Counsel failed to disclose these additional amounts to the court or seek permission to obtain them. As a result, the court ordered disgorgement of fees and suspension of filing new petitions for a temporary period. *Id*.

In short, DISCLOSE, and if you have a question about what needs to be disclosed err on the side of full disclosure…your wallet will thank you.

Brian Behr is a Staff Attorney with the U.S. Bankruptcy Administrator for the Eastern District of North Carolina.

Charting the Murky Waters: Treatment of Stern Claims in North Carolina

By Bethany A. Corbin

The hotly-debated case of **Stern v. Marshall** elicits groans, head banging, and repetitive eye rolling at its mere mention. Perceived as a cancerous growth eating away at the once simplistic concept of bankruptcy authority, **Stern** created confusion and controversy unparalleled in bankruptcy jurisprudence. Since the 2011 ruling, courts and practitioners have struggled to define the jurisdictional powers of bankruptcy judges, and the results nationwide have been less than uniform. This article provides a condensed overview of North Carolina's treatment of several types of **Stern** claims and examines North Carolina's approach to consensual bankruptcy authority.

The Stern Framework

According to the United States Supreme Court, bankruptcy judges must engage in a two-step analysis to determine if a claim is capable of final adjudication by an Article I tribunal. Specifically, bankruptcy courts must find that a claim is both statutorily *and* constitutionally core before entering a final order. This two-prong analysis limits bankruptcy authority to actions that either (1) arise in the bankruptcy case itself or (2) are necessarily resolved in the claims allowance process. **Stern v. Marshall**, — U.S. —, 131 S. Ct. 2594, 2618 (2011). Satisfaction of either prong results in bankruptcy authority for final adjudication; however, failure of both prongs limits bankruptcy courts to the issuance of proposed findings of fact and conclusions of law for the district court's *de novo* review.

North Carolina's Treatment of Stern Claims

In determining whether bankruptcy courts possess authority over particular *Stern* claims, North Carolina bankruptcy judges have focused extensively on the claims allowance process. Specifically, these judges are quick to note that state law claims for relief rarely arise in the bankruptcy case itself, and they devote little time to further explanation of this prong. *See* **Southeastern Materials, Inc.**, 467 B.R. 337, 359 (Bankr.M.D.N.C. 2012) (repeating several times that certain claims are state law tort actions and therefore do not arise under the Bankruptcy Code). Instead, the bankruptcy judges primarily enter final orders on state law causes of action based on the claim's direct impact on either the monetary value alleged in the proof of claim or a determination of whether the proof of claim can even be allowed. *See, e.g.*, **In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 775-76 (Bankr.M.D.N.C. 2012) ("**Freeway Foods**") (holding that it is necessary to determine whether the security agreements were breached before deciding whether to allow the creditor's proof of claim or provide injunctive relief).

If the state law claim must necessarily be decided in order to allow or disallow a creditor's proof of claim, then the bankruptcy court may enter a final judgment. *See* **In re Brier Creek Corporate Center Assocs. Ltd. P'ship**, Ch. 11 Case No. 12-01855, Adv. No. 12-00121, 2013 WL 492461, at *7 (Bankr.E.D.N.C. Feb. 8, 2013) ("**Brier Creek**") (determining that resolution of a breach of contract claim will necessarily affect the claims allowance process). *But see* **In re TP, Inc.**, 479 B.R. 373, 387 (Bankr.E.D.N.C. 2012) (finding that an alter ego claim failed to satisfy both prongs of **Stern** where it did not affect the calculation of Bank of America's proof of claim). Thus, parties seeking to invoke a bankruptcy court's authority to issue a final determination should highlight in detail the action's impact on the claims allowance process.

A caveat, however, has emerged in North Carolina regarding augmentation of the estate. Where a state law claim seeks affirmative monetary relief to increase the size of the estate rather than to reduce the lender's proof of claim, bankruptcy courts lack authority to enter a final judgment. *See* **In re TP, Inc.**, 479 B.R. at 384-87; *see also* **In re Somerset Prop. SPE, LLC**, Ch. 11 Case No. 10-09210, Adv. No. 11-00053, 2012 WL 3877791, at *8-9 (Bankr.E.D.N.C. Sept. 6, 2012) ("**SPE**"). This caveat is premised on the Supreme Court's distinction in **Granfinanciera, S.A. v. Nordberg**, between actions that merely enlarge the bankruptcy estate and actions that determine a creditor's right to participate in the estate's distribution. 492 U.S. 33, 35 (1989). Actions that implicate the claims allowance process to obtain a pro rata share of the bankruptcy res are both constitutionally and statutorily core and, therefore, warrant final adjudication by the bankruptcy judge. Thus, for a bankruptcy court to enter a final judgment on a state law claim in North Carolina, the claim must either (1) arise in the bankruptcy case itself, or (2) directly affect the claims allowance process but not seek augmentation of the bankruptcy estate.

Although the impact of a state law cause of action on the claims allowance process is a fact-specific inquiry, North Carolina bankruptcy courts have held that the following causes of action may result in final adjudication by the bankruptcy court: (1) actions seeking declaratory judgment; (2) equitable subordination; (3) preference claims *if* the creditor has filed a proof of claim; (4) rescission; and (5) setoff. These actions are perceived as inextricably intertwined with the proofs of claim and, therefore, directly affect the claims allowance process.

In contrast, these same courts are limited to the submission of proposed findings of fact and conclusions of law to the district court for the following claims: (1) accountings; (2) alter ego; (3) breach of fiduciary duty; (4) conspiracy; (5) conversion; (6) defamation; (7) fraud; (8) negligence and/or negligent misrepresentation; (9) tortious interference; (10) unfair and deceptive trade practices; (11) uniform fraudulent transfer act; and (12) unjust enrichment. The primary reason cited by bankruptcy courts for their inability to issue final orders on these claims is the lack of connectivity between the claims allowance process and the state law cause of action. *See, e.g.*, **TP, Inc.**, 479 B.R. at 387 (refusing to enter a final order where the alter ego claim arose prior to the petition date and was based purely on state law). According to the courts, these causes of action are too removed from the claims allowance process to justify adjudication by the bankruptcy court.

Finally, no consensus has been reached between North Carolina bankruptcy judges on the following claims: (1) breach of contract; (2) breach of the duty of good faith and fair dealing; (3) constructive fraud; (4) fraud in the inducement; and (5) piercing the corporate veil. Disagreement over these claims results from differences in case facts, whether the claim occurred pre- or post-petition, and whether the primary purpose of the claim is to augment the estate. *Compare* **SPE**, 2012 WL 3877791, at *8-9 (declining to enter a final judgment where the bankruptcy estate sought affirmative monetary relief and the breach of contract action was not sufficiently intertwined with the lender's proof of claim), *with* **Brier Creek**, 2013 WL 492461, at *7 (entering a final order where the breach of contract claim was necessary to a final resolution of Bank of America's proof of claim). Thus, arguments exist both for and against final adjudication by bankruptcy judges of these five types of claims, and the outcomes will likely be fact-specific.

Consenting to Bankruptcy Authority

In the event that a state law claim does not satisfy the **Stern** criteria, North Carolina courts (and courts within the Fourth Circuit generally) have nonetheless allowed parties to consent to bankruptcy jurisdiction. *See* **Freeway Foods.**, 466 B.R. at 776, 781-86 (entering a final order where the parties consented). These courts have interpreted **Stern** narrowly, adhering to the proposition that **Stern** does not affect subject matter jurisdiction. *See* **Stern**, 131 S. Ct. at 2607. Instead, a bankruptcy court's authority is perceived as a waivable private right that does not implicate Article III protections. *See, e.g.*, **In re Connelly**, 476 B.R. 223, 233-34 (Bankr. E.D. Va. 2012) (holding that the ability to consent to bankruptcy authority was expressly recognized in **Stern** when the Court clarified that it was not adjudicating the subject matter jurisdiction of bankruptcy courts). As such, parties are able to waive any objection to final bankruptcy court adjudication through consent. This approach results in the efficient administration of claims and conserves judicial resources.

However, while courts within the Fourth Circuit have recognized and permitted consensual adjudication, the Fifth, Sixth, and Seventh Circuit Courts of Appeals have ruled conversely on the issue of consent. According to these Circuits, consent invokes the separation of powers, and Article III limitations are necessary to prevent abuse and impermissible bias. **Frazin v. Haynes & Boone, LLP (In re Frazin)**, 732 F.3d 313, 320 n.3 (5th Cir. 2013); *see* **Wellness Int'l Network, Ltd. v. Sharif**, 727 F.3d 751, 767-75 (7th Cir. 2013), *cert. granted*, 2014 WL 497634 (July 1, 2014) ("**Sharif**"). Although the United States Supreme Court was slated to resolve the circuit split on consent during the October 2013 term in **Executive Benefits Insurance Agency v. Arkison**, the Court reserved the issue for another day. 573 U.S. —, 134 S. Ct. 2165, 2170 n.4 (2014). Ironically, that "other day" has already been scheduled: On July 1, 2014, the Court granted certiorari in **Sharif** to decide whether consent is sufficient to confer authority on Article I judges. Thus, at this point in time, it is unknown whether North Carolina's approach to consent will hold water.

Nonetheless, despite the Supreme Court's avoidance of the consent question, a strong argument exists that the plain language of **Executive Benefits** actually resolves the consent issue. In **Executive Benefits**, Justice Thomas broadly authorized application of 28 U.S.C. § 157(c) in its entirety to **Stern** claims. **Executive Benefits**, 134 S. Ct. at 2173 ("The statute permits **Stern** claims to proceed as non-core within the meaning of § 157(c)."). Section 157(c) includes two distinct subsections: (1) authorization for bankruptcy courts to issue proposed findings of fact and conclusions of law for non-core proceedings, and (2) recognition of a party's ability to consent to bankruptcy authority over non-core matters. 28 U.S.C. § 157(c) (2013). The Court's intention with its language was to bridge the metaphorical **Stern** gap by allowing bankruptcy judges to submit proposed findings of fact and conclusions of law for statutorily core claims that cannot be constitutionally adjudicated in Article I tribunals. Put differently, the Court sought to clarify the treatment of **Stern** claims by acknowledging the authority of bankruptcy courts to submit proposed findings and conclusions to the district court on such claims.

However, by failing to limit his statutory reference solely to Section 157(c)(1), Justice Thomas (perhaps inadvertently) encompassed consent under Section 157(c)(2) within his holding. The Court's opinion refers to Section 157(c) at least three times so it cannot be labeled as a mere oversight. Thus, the plain language of **Executive Benefits** contradicts the Supreme Court's outward declaration of refusal to decide the consent question. It is difficult to understand how this plain language could be given effect if the Supreme Court arrived at a contrary holding in **Sharif**. Therefore, given the express text of **Executive Benefits** it is unlikely that North Carolina's permissive approach to jurisdictional consent will be deemed unconstitutional.

Conclusion and Tabular Reference

In summary, based on case law from the North Carolina bankruptcy courts, a **Stern** claim can be finally adjudicated by a bankruptcy judge if: (1) the claim arises in the bankruptcy proceeding or arises under the Bankruptcy Code, (2) the action is inherent to the claims allowance process and does not seek to augment the estate, or (3) the parties consent. The attached chart serves as a reference tool for understanding how North Carolina courts have adjudicated certain state law claims, and offers case citations for the supporting opinions. The chart is not intended as a comprehensive compilation of all North Carolina cases on the subject, but rather provides a representative sample of opinions throughout the districts.

Bethany Corbin is a law clerk to the Honorable Lena M. James. She joins Bradley Arant Boult Cummings LLP as an associate in October 2014.

Stern Claims in North Carolina Courts

Claim Type	Jurisdiction	Court	Case Citation(s)
Accounting	Proposed Findings of Fact and Conclusions of Law	Bankruptcy Court Middle District of North Carolina	**In re Southeastern Materials, Inc.**, 467 B.R. 337, 360-61 (Bankr. M.D.N.C. 2012).
Alter Ego	Proposed Findings of Fact and Conclusions of Law	Bankruptcy Court Middle District of North Carolina	**In re Southeastern Materials, Inc.**, 467 B.R. 337, 360 (Bankr. M.D.N.C. 2012).
		Bankruptcy Court Middle District of North Carolina	**In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 785 (Bankr. M.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 387 (Bankr. E.D.N.C. 2012).
Breach of Contract or Settlement Agreement	Proposed Findings of Fact and Conclusions of Law	Bankruptcy Court Eastern District of North Carolina	**In re Somerset Prop. SPE, LLC**, Ch. 11 Case No. 10-09210, Adv. No. 11-00053, 2012 WL 3877791, at *8-9 (Bankr. E.D.N.C. Sept. 6, 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 386-87 (Bankr. E.D.N.C. 2012).
	Final Order	Bankruptcy Court Middle District of North Carolina	**In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 782 (Bankr. M.D.N.C. 2012).
		Bankruptcy Court Middle District of North Carolina	**In re Clean Burn Fuels, LLC**, Ch. 7 Case No. 11-80562, Adv. No. 11-09046, 2014 WL 3305549, at *5-10 (Bankr. M.D.N.C. June 28, 2013).
		Bankruptcy Court Eastern District of North Carolina	**In re Brier Creek Corporate Ctr. Assocs. Ltd. P'ship**, Ch. 11 Case No. 12-01855, Adv. No. 12-00121, 2013 WL 492461, at *7 (Bankr. E.D.N.C. Feb. 8, 2013).
Breach of Good Faith & Fair Dealing	Final Order	Bankruptcy Court Eastern District of North Carolina	**In re Somerset Prop. SPE, LLC**, Ch. 11 Case No. 10-09210, Adv. No. 11-00053, 2012 WL 3877791, at *6 (Bankr. E.D.N.C. Sept. 6, 2012).
	Proposed Findings of Fact and Conclusions of Law Unless Consent	Bankruptcy Court Middle District of North Carolina	**In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 781-82 (Bankr. M.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 386-87 (Bankr. E.D.N.C. 2012).
Breach of Fiduciary Duty	Proposed Findings of Fact and Conclusions of Law	Bankruptcy Court Middle District of North Carolina	**In re Southeastern Materials, Inc.**, 467 B.R. 337, 358-59 (Bankr. M.D.N.C. 2012).
		Bankruptcy Court Western District of North Carolina	**In re Robinson**, Ch. 13 Case No. 11-51047, Adv. No. 12-5032, 2012 WL 3638007, at *4 (Bankr. W.D.N.C. Aug. 22, 2012)
		Bankruptcy Court Eastern District of North Carolina	**In re Brier Creek Corporate Ctr. Assocs. Ltd. P'ship**, Ch. 11 Case No. 12-01855, Adv. No. 12-00121, 2013 WL 492461, at *7 (Bankr. E.D.N.C. Feb. 8, 2013).
		Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 386 (Bankr. E.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re Brown**, Ch. 7 Case No. 07-02856, Adv. No. 08-00230, 2012 WL 2367090, at *6 (Bankr. E.D.N.C. June 21, 2012).

Stern Claims in North Carolina Courts, continued

Conspiracy	Proposed Findings of Fact and Conclusions of Law Unless Consent	Bankruptcy Court Middle District of North Carolina	**In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 784-85 (Bankr. M.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re Brown**, Ch. 7 Case No. 07-02856, Adv. No. 08-00230, 2012 WL 2367090, at *6 (Bankr. E.D.N.C. June 21, 2012).
Constructive Fraud	Proposed Findings of Fact and Conclusions of Law	Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 384-85 (Bankr. E.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re Brown**, Ch. 7 Case No. 07-02856, Adv. No. 08-00230, 2012 WL 2367090, at *6 (Bankr. E.D.N.C. June 21, 2012).
	Final Order	Bankruptcy Court Western District of North Carolina	**In re Jenkins**, Ch. 7 Case No. 12-50413, Adv. No. 12-5033, 2012 WL 6186347, at *2 (Bankr. W.D.N.C. Dec. 12, 2012).
Conversion	Proposed Findings of Fact and Conclusions of Law Unless Consent	Bankruptcy Court Middle District of North Carolina	**In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 783 (Bankr. M.D.N.C. 2012).
Declaratory Judgment	Final Order	Bankruptcy Court Eastern District of North Carolina	**In re Somerset Properties SPE, LLC**, Ch. 11 Case No. 10-09210, Adv. No. 11-00053, 2012 WL 3877791, at *10 (Bankr. E.D.N.C. Sept. 6, 2012).
		Bankruptcy Court Middle District of North Carolina	**In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 779-80 (Bankr. M.D.N.C. 2012).
Defamation	Proposed Findings of Fact and Conclusions of Law Unless Consent	Bankruptcy Court Middle District of North Carolina	**In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 778 (Bankr. M.D.N.C. 2012).
		District Court Western District of North Carolina	**Blue Cross & Blue Shield of N.C. v. Jemsek Clinic, P.A.**, 506 B.R. 694, 696 (W.D.N.C. 2014).
Equitable Subordination	Final Order	Bankruptcy Court Middle District of North Carolina	**In re Southeastern Materials, Inc.**, 467 B.R. 337, 361 (Bankr. M.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 387 (Bankr. E.D.N.C. 2012).
Fraud	Proposed Findings of Fact and Conclusions of Law Unless Consent	Bankruptcy Court Middle District of North Carolina	**In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 784 (Bankr. M.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 385 (Bankr. E.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re Brown**, Ch. 7 Case No. 07-02856, Adv. No. 08-00230, 2012 WL 2367090, at *6 (Bankr. E.D.N.C. June 21, 2012).
Fraud in the Inducement	Final Order	Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 385 (Bankr. E.D.N.C. 2012).
	Proposed Findings of Fact and Conclusions of Law	Bankruptcy Court Eastern District of North Carolina	**In re Brier Creek Corporate Ctr. Assocs. Ltd. P'ship**, Ch. 11 Case No. 12-01855, Adv. No. 12-00121, 2013 WL 492461, at *7 (Bankr. E.D.N.C. Feb. 8, 2013).
Negligence and Negligent Misrepresentation	Proposed Findings of Fact and Conclusions of Law	Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 386 (Bankr. E.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re Brown**, Ch. 7 Case No. 07-02856, Adv. No. 08-00230, 2012 WL 2367090, at *6 (Bankr. E.D.N.C. June 21, 2012).

Stern Claims in North Carolina Courts, continued

Piercing the Corporate Veil	Proposed Findings of Fact and Conclusions of Law	Bankruptcy Court Eastern District of North Carolina	**In re Brown**, Ch. 7 Case No. 07-02856, Adv. No. 08-00230, 2012 WL 2367090, at *6 (Bankr. E.D.N.C. June 21, 2012).
	Final Order	Bankruptcy Court Middle District of North Carolina	**In re Barnhart**, Ch. 7 Case No. 11-800307, Adv. No. 11-09059, 2013 WL 3779908, at *1 (Bankr. M.D.N.C. July 18, 2013).
Preference Claims	Final Order *if* Creditor Filed Proof of Claim	Bankruptcy Court Middle District of North Carolina	**In re Southeastern Materials, Inc.**, 467 B.R. 337, 352 (Bankr. M.D.N.C. 2012).
Rescission	Final Order	Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 385-86 (Bankr. E.D.N.C. 2012).
Setoff	Final Order	Bankruptcy Court Middle District of North Carolina	**In re Clean Burn Fuels, LLC**, Ch. 7 Case No. 11-80562, Adv. No. 11-09046, 2014 WL 3305549, at *5-10 (Bankr. M.D.N.C. June 28, 2013).
Tortious Interference	Proposed Findings of Fact and Conclusions of Law Unless Consent	Bankruptcy Court Eastern District of North Carolina	**In re Somerset Prop. SPE, LLC**, Ch. 11 Case No. 10-09210, Adv. No. 11-00053, 2012 WL 3877791, at *10 (Bankr. E.D.N.C. Sept. 6, 2012).
		Bankruptcy Court Middle District of North Carolina	**In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 781 (Bankr. M.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 386 (Bankr. E.D.N.C. 2012).
		District Court Western District of North Carolina	**Blue Cross & Blue Shield of N.C. v. Jemsek Clinic, P.A.**, 506 B.R. 694, 696 (W.D.N.C. 2014).
Unfair & Deceptive Trade Practices Act	Proposed Findings of Fact and Conclusions of Law	Bankruptcy Court Eastern District of North Carolina	**In re Somerset Prop. SPE, LLC**, Ch. 11 Case No. 10-09210, Adv. No. 11-00053, 2012 WL 3877791, at *10 (Bankr. E.D.N.C. Sept. 6, 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re TP, Inc.**, 479 B.R. 373, 387 (Bankr. E.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re Brier Creek Corporate Ctr. Assocs. Ltd. P'ship**, Ch. 11 Case No. 12-01855, Adv. No. 12-00121, 2013 WL 492461, at *8 (Bankr. E.D.N.C. Feb. 8, 2013).
		Bankruptcy Court Eastern District of North Carolina	**In re Brown**, Ch. 7 Case No. 07-02856, Adv. No. 08-00230, 2012 WL 2367090, at *6 (Bankr. E.D.N.C. June 21, 2012).
		Bankruptcy Court Middle District of North Carolina	**In re Southeastern Materials, Inc.**, 467 B.R. 337, 359-60 (Bankr. M.D.N.C. 2012).
Uniform Fraudulent Transfer Act	Proposed Findings of Fact and Conclusions of Law Unless Consent	Bankruptcy Court Middle District of North Carolina	**In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 776 (Bankr. M.D.N.C. 2012).
Unjust Enrichment	Proposed Findings of Fact and Conclusions of Law Unless Consent	Bankruptcy Court Middle District of North Carolina	**In re Southeastern Materials, Inc.**, 467 B.R. 337, 360, 366 (Bankr. M.D.N.C. 2012).
		Bankruptcy Court Middle District of North Carolina	**In re Freeway Foods of Greensboro, Inc.**, 466 B.R. 750, 781 (Bankr. M.D.N.C. 2012).
		Bankruptcy Court Eastern District of North Carolina	**In re Brown**, Ch. 7 Case No. 07-02856, Adv. No. 08-00230, 2012 WL 2367090, at *6 (Bankr. E.D.N.C. June 21, 2012).

Is it the End of Credit Bidding As We Know It?

By Amos U. Priester IV* and Anna B. Osterhout

Two recent cases, **Fisker Automotive Holdings, Inc.**[1] and **Free Lance-Star**,[2] have been the subject of much commentary and discussion among bankruptcy practitioners and the legal community generally. As many bankruptcy practitioners are aware, the courts in **Fisker** and **Free Lance-Star** each found "cause" to cap and condition a secured creditor's credit bid in a Section 363 asset sale based on a perceived chilling of the competitive sale process. While some of the resulting discussion has been well-reasoned and nuanced, some commentators have suggested that **Fisker** and **Free Lance-Star** are the beginning of the end of credit bidding in Section 363 sales. With Section 363 asset sales now being a major event and often the concluding action in many Chapter 11 cases,[3] limitations or restrictions on a secured creditor's right to credit bid could have dramatic implications for Chapter 11 reorganization practice.

As discussed in more detail below, we take a less dramatic view of the **Fisker** and **Free Lance-Star** decisions. Are they important decisions? Absolutely, and these decisions provide solid precedent for creative lawyering in the right fact situations. But are **Fisker** and **Free Lance-Star** the end of credit bidding as we know it? No, not by a long shot, although it will be interesting to monitor the effects of these decisions, with both their intended and unintended consequences, as they play out in the credit markets and in bankruptcy practice.

Section 363(k)

A secured creditor is entitled to credit bid its allowed claim pursuant to Section 363(k) of the Bankruptcy Code. *See Radlax Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065, 182 L. Ed. 2d 967 (2012). Among other things, the ability to credit bid in a bankruptcy sale protects the interests and expectations of a secured creditor's previously negotiated and bargained position, enabling the secured creditor to rely upon its collateral in bankruptcy much the same way it would look to its collateral in a non-bankruptcy default situation. Section 363(k) provides:

> At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

11 U.S.C. § 363(k).

Section 363(k) imposes at least two restrictions on a secured creditor's right to credit bid. First, the property to be sold must be "subject to a lien that secures an allowed claim." Second, if the creditor holds a valid claim and lien, the creditor may credit bid "unless the court for cause orders otherwise." Thus, Section 363(k) allows a court, in its discretion, to abrogate a creditor's right to credit bid "for cause." *In re L.L. Murphrey Company*, No. 12-03837-8-JRL (Bankr. E.D.N.C. June 6, 2013). The Bankruptcy Code does not define "cause." Prior to **Fisker** and **Free Lance-Star**, courts generally found cause to deny or condition a secured creditor's right to credit bid under Section 363(k) when a sufficient dispute existed regarding the lien forming the basis for the credit bid. While disputes existed regarding the liens forming the basis of the credit bids in both **Fisker** and **Free Lance-Star** (as discussed in more detail below), each case also involved various lender activities that the respective courts thought would chill (or even freeze) competitive bidding in the proposed asset sales. It is this potential chilling effect on the competitive sale process, and the emphasis on that chilling effect in the **Fisker** and **Free Lance-Star** opinions, that has led to the ensuing discussion and speculation about the potential ramifications of these two opinions.

Fisker

Fisker Automotive Holdings, Inc. and Fisker Automotive, Inc. (collectively, "Fisker") were founded in 2007 to manufacture hybrid electric vehicles. Fisker's operations did not meet expectations due to challenges involving safety recalls, loss of significant inventory in Hurricane Sandy, and loss of a lending facility through the United States Department of Energy (the "DOE"). *In re Fisker Automotive Holdings, Inc., et al.*, 510 B.R. 55, 56 (Bankr. Del. 2014). At a public auction on Oct. 11, 2013, Hybrid Tech Holdings, LLC ("Hybrid") acquired the DOE's $168.5 million interest in a secured loan to Fisker with a bid of $25 million, and Hybrid thereby succeeded to DOE's position as Fisker's senior secured lender. *Id.* at 57. Subsequently, Hybrid entered into an Asset Purchase Agreement with Fisker pursuant to which it was to acquire Fisker's assets through a $75 million credit bid. Fisker filed Chapter 11 in Delaware on Nov. 22, 2013 with a goal of selling substantially all of its assets to Hybrid and then administering the remaining estate through a liquidating plan. *Id.* at 57-58.

When Fisker sought authorization from the bankruptcy court to consummate the private sale to Hybrid, the Official Committee of Unsecured Creditors (the "Committee") opposed Hybrid's right to credit bid. The Committee instead supported an auction involving Wanxiang America Corporation ("Wanxiang") which had made an attractive competing proposal. Wanxiang, however, made it clear that it would not participate in an auction if Hybrid was entitled to credit bid more than $25 million. *Id* at 59.

The court noted that under the plain language of Section 363(k), a lender's right to credit bid is not absolute and may be limited for cause. The **Fisker** court cited **In re Philadelphia Newspapers** in which the Third Circuit Court of Appeals stated in a footnote, "[a] court may deny a lender the right to credit bid in the interest of any policy advanced by the Code, such as to ensure the success of the reorganization or to foster a competitive bidding environment. *See, e.g.* 3 Collier on Bankruptcy 363.09[1] (the Court might [deny credit bidding] if permitting a lienholder to bid would chill the bidding process)." *Id.* at 59-60, *citing In re Philadelphia Newspapers*, 599 F.3d 298 (3d Cir. 2010), 315-316.

The **Fisker** court ultimately granted a motion to cap Hybrid's right to credit bid "for cause." The court relied upon, among other things, a stipulation between the Committee and Fisker that there would be no bidding, not just a chilling of the bidding, if Hybrid's credit bid was not limited. In addition, the court expressed serious concerns about the short timeframe between the petition date and the proposed sale date, noting that neither Fisker nor Hybrid provided the court with a satisfactory reason why the sale required such speed, nor did the parties respond to the court's admonitions that the timing of the motion for approval of the sale was troublesome. The court found that Hybrid's rush to purchase was "inconsistent with the notions of fairness in the bankruptcy process." *Id.* at 60.

Importantly, the court also noted that the Committee and Hybrid stipulated that Hybrid's claim was partially secured, partially unsecured, and of uncertain status as to the remainder of its claim, meaning that the court could not determine how much of Hybrid's claim was an allowed secured claim for purposes of Section 363(k). The court noted that the law is clear that the holder of a lien, the validity of which has not been determined, may not bid its lien. *Id.* at 60, *citing In re Daufuskie Island Props., LLC*, 441 B.R. 60 (Bankr. D.S.C. 2010). As such, the court limited Hybrid's credit bid to $25 million for cause,[4] because "[t]o do otherwise would freeze bidding." *Id.* at 60.

Hybrid appealed the order capping the amount of its credit bid. The district court found that Hybrid could not appeal the interlocutory order as of right and denied Hybrid's request for permissive appeal.[5]

Free Lance-Star

Free Lance-Star was a family-owned publishing, newspaper, radio, and communications company. Free Lance-Star owned various assets including certain tower assets which included three parcels of real estate (the "Tower Parcels"). *In re The Free Lance-Star,* 2014 Bankr. LEXIS 1611 (April 14, 2014).

In 2006 Free Lance-Star and an affiliate (collectively, the "Debtors") undertook an expansion of their commercial printing business. The Debtors borrowed $50.8 million from BB&T in order to fund the expansion. To secure the loan, the Debtors granted BB&T liens on and security interests in certain real and personal property. The Debtors did not grant BB&T a lien on the tower assets, nor did BB&T record deeds of trust covering the Tower Parcels. In early 2009 the Debtors defaulted on certain loan covenants. BB&T ultimately sold its loan to Sandton Capital Partners ("Sandton") in late June 2013. *Id.* at *8-9.

Shortly after purchasing the loan, Sandton advised the Debtors that it wanted the Debtors to file bankruptcy and sell substantially all of their assets to Sandton's affiliate, DSP Acquisition, LLC ("DSP"), pursuant to Section 363. In late July 2013 DSP requested that the Debtors execute three deeds of trust that would encumber the Tower Parcels. In addition, DSP provided a restructuring timetable that included recordation of the deeds of trust and commencement of a bankruptcy case in September 2013. *Id.* at *9-10. Following various communications regarding the restructuring timetable, negotiations between the parties ended abruptly. Subsequently, DSP unilaterally recorded UCC fixture filings against the Tower Parcels without the Debtors' knowledge or consent. *Id.* at *11.

Negotiations resumed in September 2013, and DSP provided a revised forbearance agreement that included a blanket release of all claims against DSP. However, the revised forbearance agreement did not require that the Debtors execute deeds of trust on the Tower Parcels because DSP indicated that it "expected to pick up that collateral in a DIP post-petition financing order." *Id.* at *12. Ninety days after recording the UCC fixture filings, DSP renewed pressure on the Debtors to file bankruptcy quickly. In a planning meeting between the parties, DSP indicated that there was no reason for the Debtors to market their assets, and that the timeframe for conducting a bankruptcy sale with its credit bid should be no more than six weeks from the petition date to closing. *Id.* at *12-13.

The Debtors' financial consultant insisted on distributing marketing materials regarding the sale. In response, DSP required that the materials include a conspicuous statement indicating that DSP had a right to a $39 million credit bid. When the financial consultant projected that the Debtors would have sufficient cash flow to survive bankruptcy without post-petition financing, DSP insisted that the consultant's projections were overly optimistic and that DSP had to provide the Debtors a new post-petition loan facility. Without such a loan DSP could not get a lien on the tower assets. The Debtors refused the new loan, and all negotiations between the parties ceased. In mid-January 2014, DSP recorded additional financing statements in various jurisdictions, again without the Debtors' knowledge or consent. *Id.* at *13-14.

The Debtors filed bankruptcy in the Eastern District of Virginia on Jan. 23, 2014, without DSP's support. Subsequently, DSP objected to the Debtors' use of cash collateral and requested liens on the tower assets as additional adequate protection to supplement post-petition replacement liens and adequate protection payments offered by the Debtors. DSP did not disclose to the court or to the Debtors that it had recorded fixture filings against the tower assets in August 2013 and January 2014. The court denied DSP's request for the supplemental liens and found that DSP's interest in cash collateral was adequately protected. *Id.* at *1, 14-15.

Concurrent with filing the petition, the Debtors filed motions to sell the business assets and the tower assets. On March 10, 2014 the court entered orders approving the bidding procedures set forth in the motions, including the right of DSP to credit bid its claim against the Debtors' assets on which it had valid liens or security interests, as (i) agreed to by the Debtors, DSP and the Committee, or (ii) determined by the court. *Id.* at *2. On the same date, DSP filed a complaint initiating an adversary proceeding in which it sought a declaration that DSP held valid, perfected liens on substantially all of the Debtors' assets, including the tower assets. The bankruptcy court conducted a hearing on cross motions for summary judgment to determine (i) DSP's right to credit bid its claim against the Debtors' assets in connection with the sale motions, and (ii) the extent, validity and priority of the liens DSP asserted against the Debtors' assets. *Id.* at *3. Importantly, at the hearing DSP presented no evidence of the validity, priority, or extent of its liens, despite the court's determination that DSP had the burden of proof on this issue pursuant to Section 363(p)(2).

The bankruptcy court found cause pursuant to Section 363(k) to limit DSP's right to credit bid based upon several factors. First, the court held that DSP did not have valid, perfected liens on certain of the Debtors' assets including, but not limited to, the tower assets. As such, DSP could not credit bid on those assets as they did not secure DSP's allowed claims. Second, the court was troubled that DSP unilaterally recorded the UCC fixture filings in August 2013 and January 2014 yet neglected to disclose the fixture filings at the cash collateral hearing when DSP requested liens on the same assets. Third, the court noted that from the moment DSP purchased the loan it pushed the Debtors toward an expedited bankruptcy process in a classic loan-to-own scenario. Finally, the court was concerned with DSP's efforts to frustrate the competitive bidding process by pressuring the Debtors to shorten the marketing period for the sale and to include language in the marketing materials that conspicuously advertised DSP's right to credit bid. *Id.* at *22-23.

Based upon the uncontroverted evidence, in order to foster a fair and robust sale, the court limited DSP from bidding the full amount of its claim against all of the Debtors' assets. The court found that the confluence of (i) DSP's less than fully-secured lien status, (ii) DSP's overly zealous loan-to-own strategy, and (iii) the negative impact DSP's misconduct had on the auction process created "the perfect storm" which required the court to curtail DSP's right to credit bid. *Id.* at *25. The court noted that limiting DSP's credit bid would renew interest in the bidding process and serve to increase the value realized for the assets. As such, the court limited DSP's right to credit bid under Section 363(k) to (a) $1.2 million for assets related to the Debtors' radio business on which DSP had a valid, properly-perfected lien and to (b) $12.7 million for assets related to the Debtors' newspaper and printing business on which DSP had a valid, properly-perfected lien. *Id.* at *26.

DSP sought to appeal the bankruptcy court's order by filing a notice of appeal, filing a motion to certify the bankruptcy court's order as final, and requesting expedited consideration of its motion in an effort to obtain relief in advance of the auction. Based on reasoning similar to that of the **Fisker** court, the bankruptcy court and district court denied all relief DSP requested with regard to the appeal.[6]

Where Do Secured Creditors Go From Here?

Lenders and distressed debt investors have viewed the **Fisker** and **Free Lance-Star** opinions as problematic, potentially crippling a secured creditor's right to credit bid. As seen in **Fisker** and **Free Lance-Star**, caps on credit bidding hamper the distressed debt investor's ability to control the sale environment and its purchase of the target assets. Similarly, conditioning or losing the right to credit bid also is a concern for every secured lender, whether that lender simply seeks to realize on its collateral or it wishes to bid up the purchase price at a sale such that the lender might be able to obtain a higher recovery on its loan. While it is true that these cases signal more challenges for creditors seeking to credit bid, it is important to understand what these two opinions do not hold: neither case stands for the proposition that every credit bid, including a credit bid based on a loan purchased at substantial discount, automatically is suspect or should be limited.

Speculation abounds as to whether the **Fisker** and **Free Lance-Star** opinions are the beginning of a trend in which bankruptcy courts will determine that credit bids should be capped "for cause" pursuant to Section 363(k) simply to promote a competitive sale process. However, it is important to note that while the bankruptcy courts in **Fisker** and **Free Lance-Star** capped each creditor's ability to credit bid ostensibly in order to promote competitive bidding, other significant factors also were at play and seemingly affected each court's decision. For example, the creditor in each case participated in aggressive loan-to-own strategies and possibly inequitable conduct that each of the respective courts found troubling. In addition, each of the cases involved issues regarding the extent and validity of liens and, as the courts clearly noted, creditors cannot credit bid on assets on which they do not have a valid lien.

In fact, either of these factors likely would have given the courts ample reason, within the constraints of existing case law, to reach the result achieved in each case without discussion of promoting competitive bidding. Thus, while each court's competitive bidding comments may give rise to new legal theories and affect credit markets and bankruptcy practice in the future, the decisions themselves reach no unexpected results.[7] The real test will come when a court is asked to limit the credit bid of a fully-secured, properly-perfected creditor who has engaged in no inequitable conduct solely to promote possible competitive bidding.

With these facts in mind, what can a lender or a distressed debt investor do to safeguard its right to credit bid pursuant to Section 363(k)? While there certainly are no guaranteed means by which a creditor can avoid a court's determination to limit its right to credit bid for cause, a creditor may limit the possibility that a bankruptcy court will impair its right to credit bid. Possible actions a creditor may consider include:

(i) Perform proper diligence concerning the collateral when making or purchasing a secured loan, and continue to actively police the collateral during the term of the loan.

(ii) Attempt to resolve any outstanding issues regarding the status of its lien as early as possible in the bankruptcy case (or preferably, prior to the filing of the petition). For example, if an issue exists regarding the extent, validity, or priority of a lien, the creditor should take steps to address that issue prior to the proposed Section 363 sale. A determination regarding the creditor's lien could be made by consent of the parties, upon an emergency motion filed with the court, or by various other means. However the determination is made, it is important for a secured creditor to clarify its lien position prior to any Section 363 sale so that its ability to credit bid is not limited simply due to unanswered questions surrounding its lien. Resolving any lien questions prior to a Section 363 sale also clarifies which assets are subject to a secured creditor's credit bid.

(iii) Avoid at all costs any conduct that can be considered inequitable or detrimental to the bankruptcy process. Creditors should consider working closely with debtors to ensure that a proposed Section 363 sale is well run, properly marketed and sufficiently publicized. For example, the creditor might consider providing financing for the debtor to employ a reputable auctioneer or investment banker to assist with evaluation, marketing and sale of the assets. Similarly, the creditor might consider leaving designated assets in the estate, or funding a wind-down budget or dividend for unsecured creditors.

(iv) Think creatively about the structure of the Section 363 sale and the credit bid. For example, if there are questions concerning the validity of a creditor's lien on certain assets but not on others, consider pushing for the sale to take place in specified lots or batches or even for separate sales of assets that would enable the creditor to credit bid on the assets clearly subject to a valid lien and potentially avoid the court limiting its right to credit bid. By structuring a sale to maximize a creditor's ability to credit bid, the creditor may be able to achieve many, if not all, of its goals related to the sale. Most importantly, secured creditors should ensure that all of their actions related to the sale will be viewed by the court as supporting the sale process, and not as an effort to chill or otherwise block a competitive sale.

Conclusion

Fisker and **Free Lance-Star** have highlighted a potential legal theory and likely area of dispute and litigation to come, but the results of these cases are not out of line with existing precedent. What **Fisker** and **Free Lance-Star** do provide, however, is an early warning to secured creditors on how they may wish to proceed in future Section 363 sales. Since the timing of a Section 363 sale is often dictated by a debtor's cash reserve (or lack thereof) it may be difficult, or even impossible, for a lender to take actions to protect itself prior to bankruptcy. However, every lender can be diligent in policing its collateral position and perfection, thereby avoiding the most likely reason a court would limit its right to credit bid. Furthermore, to the extent a creditor is aware of, and attempts to avoid, the types of egregious or inequitable conduct exhibited by the creditors in **Fisker** and **Free Lance-Star**, the creditor may be able to approach a Section 363 sale with more confidence that its right to credit bid will not be capped. Thus, while it may be challenging or counter-intuitive for a creditor to actively support a competitive Section 363 sale, it may well be in the creditor's best interest to do so.

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(Endnotes)

1 *In re Fisker Automotive Holdings, Inc., et al.*, 510 B.R. 55 (Bankr. Del. 2014); *Hybrid Tech Holdings LLC v. Official Committee of Unsecured Creditors of Fisker Automotive Holdings Inc. (In re Fisker Automotive Holdings Inc.*), No. 14-CV-99(GMS) 2014 U.S. Dist. LEXIS 15497 (D. Del., Feb. 7, 2014); *Hybrid Tech Holdings LLC v. Official Committee of Unsecured Creditors of Fisker Automotive Holdings Inc. (In re Fisker Automotive Holdings Inc.*), No. 14-CV-99(GMS), 2014 U.S. Dist. LEXIS 17689 (D. Del. Feb. 12, 2014).

2 *In re The Free Lance-Star Publishing Co. of Fredericksburg, Va.*, No. 14-30315-KRH 2014 Bankr. LEXIS 1611 (April 14, 2014); *DSP Acquisition LLC v. The Free Lance-Star Publishing Co. of Fredericksburg, Va. (In re The Free Lance-Star Publishing Co. of Fredericksburg, Va.)*, Nos. 3:14cv303-HEH, 3:14cv304-HEH, 2014 U.S. Dist. LEXIS 63274 (E.D. Va. May 7, 2014).

3 *See* Dennis A. Meloro, Randall G. Reese, and Travis K. Vandell, *The Fast and Laborious: Chapter 11 Case Trends*, XXXIII ABI Journal 3, 52-53, 85, March 2014 (the authors' study found that over sixty percent of Chapter 11 cases filed in 2012 were "pre-planned" cases, which the authors define to include cases with pre-packaged or pre-negotiated reorganization or liquidation plans, as well as cases with immediate asset sales or liquidations). *See also* Hon. Christopher S. Sontchi, *Loan to Own is Back — With a Twist*, 27 Journal of Corporate Renewal, No. 6 (Delaware Bankruptcy Judge Sontchi concludes that secured creditors' loan-to-own strategies using Section 363 sales is "on the rise and gathering steam.")

4 The court did not limit the credit bid to $25 million based on the fact that Hybrid purchased the note for that amount. Rather, based on a stipulation of facts submitted to the court, the parties agreed that in the event the court allowed an auction and Hybrid's credit bid was capped at $25 million, there was a material chance of creating value for the estate from the sale of the assets.

5 *Hybrid Tech Holdings LLC v. Official Committee of Unsecured Creditors of Fisker Automotive Holdings Inc. (In re Fisker Automotive Holdings Inc.*), No. 14-CV-99(GMS) 2014 U.S. Dist. LEXIS 15497 (D. Del., Feb. 7, 2014); *Hybrid Tech Holdings LLC v. Official Committee of Unsecured Creditors of Fisker Automotive Holdings Inc. (In re Fisker Automotive Holdings Inc.)*, No. 14-CV-99(GMS), 2014 U.S. Dist. LEXIS 17689 (D. Del. Feb. 12, 2014).

6 *DSP Acquisition LLC v. The Free Lance-Star Publishing Co. of Fredericksburg, Va.*, Nos. 3:14cv303-HEH, 3:14cv304-HEH, 2014 U.S. Dist. LEXIS 63274 (E.D. Va. May 7, 2014).

7 As the effects of these cases play out in the future, it will be interesting to see if the courts' intended results in the fact situations of these specific cases – increasing competitive bidding and limiting loan-to-own strategies – result in a better marketplace generally for Section 363 sales, or whether the possible unintended consequences of these decisions have the opposite result more broadly. For example, an argument can be made that these decisions and others like them will have a detrimental impact upon the availability and cost of credit in the market generally (and particularly in the secondary or distressed debt market), perhaps leading to decreased, not increased, competitive bidding in Section 363 sales. Similarly, having seen the success of the potential bidder's demands concerning its participation in the **Fisker** Section 363 sale, potential bidders in other Section 363 sales increasingly may condition their involvement on specific demands or conditions which may thwart rather than promote the Section 363 sale process. Thus, rather than promoting competitive bidding, it can be argued that these opinions may trigger unintended consequences that actually end up chilling and potentially harming the competitive bidding process.

Current Issues in Credit Counseling, Debtor Education and Vendors Providing These Services

By Brian Behr and Victoria Wright

Pursuant to 11 U.S.C. § 111, a provision added as part of the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act, individual debtors are required to undergo pre-bankruptcy credit counseling and complete a post-filing financial management course. Providers of these services must be preapproved by the Bankruptcy Administrator for the District in which the debtor intends to file. A list of approved providers can be found on the website of each Bankruptcy Administrator and at the following link: ***http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyResources/ApprovedCreditAndDebtCounselors.aspx.***

These agencies are monitored and regulated by the Bankruptcy Administrators, and any suspect conduct should be brought to the attention of the Bankruptcy Administrator for the district where the debtor resides.

Debtors' attorneys know all too well that bankruptcy clients are notorious for not remembering things their attorneys tell them. While some believe that confusion on the part of a debtor is due to a lack of intelligence (which many perceive to be the reason why debtors end up in bankruptcy), in most cases debtors' memory lapses and panicked actions are simply due to the incredibly stressful situation in which they find themselves. Like attending the Section 341 Meeting of Creditors, the post-petition financial management course requirement is, with some very limited exceptions, an absolute prerequisite to receiving a discharge. *See* 11 U.S.C. § 727(a)(11) and 1328(g).

A recent ListManager discussion focused on some debtor education companies' use of public records to send mass solicitations directly to represented bankruptcy debtors. These communications give debtors the false impression that they need to take the advertised financial management course or their bankruptcy case will be dismissed. These letters are sent irrespective of whether the targeted debtor has already completed a financial management course. The letters also fail to indicate that recipients of the letters should consult with their attorney before taking the advertised course as they may have already fulfilled the financial management course requirement.

Having already filed bankruptcy and therefore "ruined their credit," there are few things more scary to consumer debtors than the thought of having their case dismissed without obtaining a discharge. Using threatening letters warning of imminent case dismissal and loss of discharge without disclosing to the recipient that the financial management course requirement might well have already been satisfied is unacceptable. While the monetary loss to individual debtors may be small, debtors victimized in this way add up to big money for unscrupulous vendors. Beyond the monetary aspect, debtors already burdened by worry are subject to additional stress and wasted time in unnecessarily completing another two-hour course.

The Bankruptcy Administrators in each of our judicial districts are aware of these solicitations and have taken action. Recently, the Bankruptcy Administrators for each district coordinated efforts to inform providers that such misleading communications are unacceptable and that failure to remove the misleading language will result in additional action being taken. The providers in question have agreed to revise their communications to remove the misleading language. Should your client receive a misleading communication from a credit counseling or financial management course provider, please transmit a copy immediately to the appropriate Bankruptcy Administrator.

Other vendor issues that trustees, court personnel, and debtors' counsel may want to be aware of are:

1. The dogs are hungry and getting more aggressive:

Vendor solicitations directed to both attorneys and debtors are increasing. There are a number of reasons for this. Decreased bankruptcy filings and price wars in the credit counseling and debtor education industry have made it harder for vendors to survive and many have sold out.

2. A rule change allows debtor education providers to file certificates, but there are different schools of thought on this:

Pursuant to a rule change effective December 1, 2013, debtor education providers are permitted, but not required, to file post-petition debtor education certificates with the bankruptcy court. Previously these certificates were filed by debtors' attorneys. The Rule change has increased competition among debtor education providers since the procedures vary by clerk's office, meaning only the biggest vendors tend to offer this service.

Some attorneys eschew this "service" and choose to hold the certificate until just before the discharge date. This allows for more flexibility if the debtor suffers an unforeseen financial catastrophe (i.e. injury, car wreck, etc.) to dismiss and refile or convert the case as may be appropriate.

3. Mortgage Modification/Credit Repair Service/Others that Prey on Debtors:

While not specifically a debtor education vendor issue, if you become aware of a client who has used a mortgage modification service, credit repair service, or has in some other way been victimized by someone preying on the vulnerability caused by their financial distress, please bring it to the attention of your respective Bankruptcy Administrator.

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Western District Case Summaries

By Sara Salehi and Derick Henderson

***Magsino v. U.S. Dep't of Education (In re Magsino)*, Case No. 12-31997, Adv. Pro. No. 12-3247 (Bankr. W.D.N.C. Apr. 4, 2014) (Whitley, J.)**

Issue: Whether the debtor could discharge her student loan obligations.

Short Answer: The debtor could not discharge her student loan obligations because she could not show that she would suffer an undue hardship if forced to repay them.

Summary: The debtor filed a no-asset Chapter 7 petition on August 20, 2012. The debtor was discharged on December 3, 2012. On November 5, 2012, the debtor filed an adversary proceeding against the United States Department of Education (the "DOE") seeking a discharge of her federal student loan obligation pursuant to 11 U.S.C. § 523(a)(8).

The court granted summary judgment for the DOE and held that the debtor did not meet the standards for dischargeability of student loan obligations under 11 U.S.C. § 523(a)(8). To discharge her student loan debt, the debtor needed to show an undue hardship if she was forced to repay the loan. The test for an "undue hardship" in the Fourth Circuit required the debtor to show, by a preponderance of evidence, that (1) she could not maintain, based on her current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans, (2) additional circumstances indicate that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans, and (3) she has made good faith efforts to repay the loans. The debtor argued that because of her age, she would be unable to secure employment and repay the loans. Additionally, the debtor argued that requiring her to repay the loans would amount to involuntary servitude prohibited by the Thirteenth Amendment. The court held that the debtor failed to meet her burden on any of the three factors.

The court noted that the DOE had offered to let the debtor participate in the Income Contingent Repayment Plan ("ICRP"), pursuant to which the debtor's monthly payments would be based on her income. Based on the debtor's income at the time, her payments were to be set at $0. Loan forgiveness would be allowed after 25 years. The debtor refused to participate. Thus, the court held that the debtor failed to meet her burden with respect to the first factor because if the debtor had opted to participate in the ICRP, repayment of her student loans would have no impact on her standard of living because her monthly payment would be $0. With respect to the second prong, the court held that age alone is not an additional circumstance that would satisfy the second prong of the test, especially without evidence of significant medical issues. Finally, the court held that the debtor did not meet her burden to show that she had made a good faith effort to repay her loans. The debtor chose not to apply any of the over $100,000 proceeds from the sale of her New Jersey condominium to paying off her federal loans, and when the sale of her real estate in Charlotte netted approximately $20,000 in cash, the debtor made only a $2,500 payment to her federal loans. Although the debtor had paid off her state and Perkins loans, she chose to do so only because her brother was a guarantor on those loans. The court additionally held that while evidence of debtor's failure to participate in the ICRP program was not per se evidence of bad faith, it was a factor to consider. The possible future tax consequences of the ICRP are too speculative to negate the otherwise obvious benefits of the ICRP. The debtor's Thirteenth Amendment argument was similarly rejected.

***Barker v. Fox Den Acres, Inc. (In re Barker)*, Case No. 12-51160, Adv. Pro. No. 13-05027 (Beyer, J.)**

Issue: Whether the debtor's claims against several defendants asserted in an adversary proceeding could be arbitrated pursuant to an arbitration agreement between the debtor and one of the defendants.

Short Answer: Yes, the debtor's claims asserted in the adversary proceeding were arbitrable because they were non-core causes of action and did not conflict with the Bankruptcy Code. The non-signatory defendants to the arbitration agreement could enforce the arbitration agreement because the claims against those defendants were intertwined and interdependent with the causes of action asserted against the signatory defendant.

Summary: The debtor filed a voluntary Chapter 13 petition on November 30, 2012. The debtor filed an adversary proceeding against several defendants on July 11, 2013. The adversary complaint alleged breach of contract, unfair and deceptive trade practices, fraud, conversion, violations of the Fair Debt Collection Practices Act, violations of the North Carolina Debt Collection Act, intentional infliction of emotional distress, negligent infliction of emotional distress, unconscionability, civil conspiracy, and improper Proof of Claim against certain of the defendants in connection with the transactions in which the debtor and her late husband acquired a manufactured home and real property on which the home was placed.

Defendants sought arbitration of all of the claims against them, respectively, based on an arbitration provision in the Retail Installment Contract - Security Agreement ("RIC") between the debtor and one of the defendants, CMH Homes, Inc. ("CMH").

The court granted the defendants' motion to compel arbitration of the claims asserted in the adversary proceeding and to stay the adversary proceeding pending the outcome of arbitration. CMH presented the RIC, which included an agreement to arbitrate. The arbitration clause was set out prominently.

The debtor argued that it was unclear whether she executed the arbitration agreement, because the arbitration clause was on the third page and her signature was on the fourth page. Debtor did not dispute that she signed the RIC and offered no evidence that page three was any different at the time she executed it; thus the court concluded that the debtor executed the RIC and that at the time of execution the RIC included the arbitration agreement.

The debtor next argued that the court should not compel arbitration because she modified the RIC in bankruptcy pursuant to 11 U.S.C. § 365(p)(3). The court held that Section 365 of the Bankruptcy Code applies to executory leases of personal property and thus has no application here as the RIC is not a lease nor was it executory. Moreover, modification of an executory contract would not constitute rejection of an arbitration agreement.

Third, the debtor argued that arbitration of her claims against CMH would be inconsistent with the Bankruptcy Code. The court was not persuaded by the debtor's argument. Debtor's causes of action against CMH were state law causes of action that do not arise under a provision of the Bankruptcy Code, CMH was not a current creditor of the debtor, and CMH had not submitted a claim against the estate. Accordingly, the causes of action against CMH were not core, and even if they were, there would not be any conflict between arbitration and the underlying purposes of the Bankruptcy Code.

Finally, the debtor contended that the arbitration agreement was unconscionable. The court held that because the arbitration clause includes a delegation clause, which reserves disputes about arbitrability for determination by an arbitrator, the court held that the debtor's unconscionability challenge should be decided by an arbitrator.

The court further held that the arbitration agreement should apply to the other defendants. Although the other defendants were not parties to the RIC, the other defendants asserted that the adversary complaint raised allegations of substantially interdependent and concerted misconduct by both the CMH and the other defendants. The court agreed. The debtor alleged that both the home and the land sales began as a common transaction, that there was concerted misconduct in the application of the down payment, which led to unfavorable financing terms for the purchase of the land and to the collection activities with which the debtor takes issue. The debtor also alleged a claim for civil conspiracy between the defendants.

Thus, because the debtor alleged common and inseparable facts, and because it would be inappropriate for the claims against the defendants to proceed in different fora, the court concluded that an arbitrator should resolve all of the debtor's claims and granted the defendants' motions to compel arbitration and stay the adversary proceeding.

***In re Jeffery Francis Rose and Katherine A. Rose*, Case No. 12-40743 (Bankr. W.D.N.C. Jul. 8, 2014) (Whitley, J.)**

Issue: Whether the Bankruptcy Code or state law in Florida or North Carolina gives the Bankruptcy Court authority to force a creditor to foreclose or accept a quitclaim deed.

Short Answer: Neither the Bankruptcy Code, nor Florida law, nor North Carolina law gives the Bankruptcy Court authority to force a creditor to foreclose or accept a quitclaim deed. However, the Court may authorize a debtor to prepare and to deliver an executed quitclaim deed to a creditor, which the creditor may be deemed to have accepted unless it affirmatively rejects delivery in a timely manner.

Summary: The debtors filed chapter 13 bankruptcy and provided in their confirmed plan for the surrender of their former Florida residence to the lienholder on the property, the Small Business Administration (the "SBA"). More than a year after confirmation, the SBA had yet to foreclose or otherwise take control of the property. The debtors found themselves subject to compounding post-petition liabilities related to the surrendered property, including property taxes and maintenance. As a result, the debtors filed a motion seeking the Court's authorization to transfer the Florida property to the SBA by quitclaim deed.

Interestingly, the debtors did not request that the Court force the SBA to accept the quitclaim deed, but only requested permission to execute, deliver, and record the deed. The Court noted, however, that such requests were becoming common. The Court considered three provisions of the Bankruptcy Code to determine whether it had the authority to force a creditor to foreclose or accept a quitclaim deed: 11 U.S.C. §1325(a)(5)(C) ("surrender of property"), §1322(b)(9) ("vesting of property"), and §105 ("catch-all" powers). The Court also looked to state law to see whether it could compel foreclosure or acceptance of a deed.

First, the Court ruled based on the "weight of authority" that the surrender of collateral pursuant to Section 1325(a)(5)(C) does not require a creditor to accept the surrendered property because "surrender" is merely a relinquishment of the debtor's rights or interests in property and not a transfer of ownership or obligations. The Court reasoned that the relinquishment of rights had no corresponding requirement that the lender do anything with the property because such a requirement would undercut the lender's control of its own state court remedies. Furthermore, the debtor's desire to shed ownership liability does not justify forcing the burdens upon a creditor that is electing not to exercise its remedies. The Court concluded that the Code did not authorize it to create substantive rights such as the right of a debtor to force a secured creditor to accept surrendered collateral.

Second, the Court ruled that a plan provision vesting property under Section 1322(b)(9) does not require a creditor to accept title to property. The Court interpreted the vesting provision as only allowing a debtor to provide for the vesting of property to a willing recipient, noting that it does not state that the property could be imposed on a third party. The Court reasoned that subjecting a creditor to ownership liabilities that it would never voluntarily assume would contravene state property law because it would impair the lender's rights in the collateral. Thus, the Court concluded that Section 1322(b)(9) does not arm debtors with a way to force property upon an unwilling recipient. For similar reasons, the Court further ruled that its "catch-all" powers under Section 105 cannot be used to alter substantive rights such as thrusting ownership liabilities upon a creditor when it elects not to use its state court remedies.

Looking to state law, the Court ruled that neither Florida nor North Carolina require a creditor to foreclose or accept title to property. The Court cited authority in both states establishing the rule that a creditor is entitle to elect what remedy it will pursue and cannot be forced to pursue any of them. Further, for a transfer of real estate to be effective, both states require delivery and acceptance of a deed. The court reasoned that allowing a debtor to unilaterally deed property to its lender could injure the lender in at least three significant ways. First, the assumption of the burdens of ownership may exceed the value of the asset. Second, in the presence of junior lienholders, the lender's priority lien position would be destroyed and it would take the property subject to junior mortgages that otherwise would have been cut off in foreclosure. Third, the presence of environmental contamination, damage, or public nuisance could subject the lender to personal liability.

While holding that the SBA could not be compelled to accept title to the debtors' property, the Court did point out that both Florida and North Carolina conveyance law might allow the debtors to transfer the property provided the SBA did not object. In both states, acceptance of a deed may be presumed by failure to renounce the deed. Therefore, the Court granted the debtors the permission they sought to tender the deed to the SBA and ordered that the deed be deemed accepted and the conveyance final if the deed was recorded after the SBA failed to reject the deed either in writing or by foreclosing within sixty days of delivery.

***In re Crawford*, Case No. 13-30843 (Bankr. W.D.N.C. June 5, 2014) (Whitley, J.)**

Issue: Whether the debtor's elderly relative living in a second property of the debtor qualifies as a dependent of the debtor for the purposes of exempting the second property as a residence under North Carolina General Statutes §1C-1601(a)(1).

Short Answer: The debtor's elderly relative was not her "dependent" at the filing date within the meaning of N.C. Gen. Stat. §1C-1601(a)(1) because the debtor's support was unsubstantiated, irregular, and in the nature of societal care not financial support.

Summary: The chapter 7 debtor, Lametsha Crawford ("Crawford") disclosed several real estate properties in her schedules, including a "rental" property in which her great uncle, David Jennings ("Jennings") lived. Jennings died shortly after Crawford filed bankruptcy. Crawford and Jennings were very close, and she became his primary caretaker when his health began declining years ago. Crawford helped Jennings attend to his medical needs, maintain his property, and pay his bills. Jennings did have sufficient retirement and social security income to support himself, but he was often taken advantage of by younger women. On these occasions, Crawford would cover his bills when he was short. However, these occasions were just that, occasional, and not regular or routine. Jennings owned the rental property until 2008 when he deeded it in fee simple ownership to Crawford. It is unclear why Jennings decided to deed the property to Crawford because he had already given her power of attorney over his affairs, and he had already provided for the property to pass to her in his will. Crawford claimed to have helped Jennings make his mortgage payments at times, but a cousin of Jennings paid his mortgage for him during the three years preceding Crawford's bankruptcy. Upon filing bankruptcy, Crawford claimed the rental property as exempt under N.C. Gen. Stat. §1C-1601(a)(1) as the residence of a dependent. The chapter 7 trustee objected.

Due to a lack of authority on the topic, the Court looked to state domestic relations cases and Black's Law Dictionary to define "dependent." Essentially, a dependent is one who is actually and substantially in need of and dependent upon another for maintenance and support without which one would not be able to exist or sustain oneself. Furthermore, the Court stated that the dependency in the residency exemption involves financial need because the purpose of the exemption is to help debtors and their families to have the shelter of a home. The Court held that Jennings was not a dependent of Crawford for three reasons. First, the Court found that Crawford's testimony that she occasionally gave Jennings money was conclusory and unsubstantiated by any source documents. She could provide no details regarding amounts, dates, or purposes when alleging contributions to Jennings' support. Second, Crawford admitted that Jennings could support himself with his income, and his cousin funded his mortgage for the three years leading up to Crawford's bankruptcy. Third, the Court found that the support Crawford provided was not primarily financial but was instead familial care, which is not the type of support contemplated by the exemption statute. Thus, the Court concluded that Jennings was not Crawford's dependent because her care for her great uncle, while admirable, was primarily societal rather than financial. The Court also noted that, even if the exemption was applicable, its coverage would have terminated upon the post-petition death of Jennings.

***In re Belk*, Case No. 12-32233, Adv. Pro. No. 13-3002 (Bankr. W.D.N.C. April 14, 2014) (Whitley, J.)**

Issue: Whether the debtor's failure to disclose his ownership and transfer of a business in Schedule B, in the Statement of Financial Affairs, and at the 341 meeting constituted a false oath or account under 11 U.S.C. §727(a)(4)(A); a knowing and fraudulent withholding of recorded information under 11 U.S.C. §727(a)(4)(D); or a failure to explain loss of assets under 11 U.S.C. §727(a)(5).

Short Answer: Yes to all three. Sufficient evidence exists to deny discharge where a debtor fails to disclose his pre-petition transfer of a business and then fails to provide sufficient records regarding the same for over a year, despite multiple demands for the records from the trustee.

Summary: Prior to the debtor's 341 meeting, the trustee asked for a copy of the debtor's 2011 federal income tax return. The debtor provided only the first two pages of his return. At the 341 meeting, the trustee reiterated his request and specified that he wanted a complete copy and all attachments. Upon receiving the complete thirty-three page tax return, the trustee discovered a corporation owned by the debtor that was omitted from the debtor's schedules and statements. The corporation had earned annual revenue of over $200,000. The trustee demanded that the debtor produce all corporate account records and tax returns for the business. In response, the debtor provided only a three-page document and scrambled to amend his schedules and statements to list the business.

Despite the dearth of information regarding the debtor's business, the trustee was able to ascertain that the debtor had transferred all of the assets of the business to a third party just prior to filing for bankruptcy relief. The debtor had attested in his petition that he had made no pre-petition transfers.

After seventeen months of enduring the debtor's insufficient responses to demands for information, the trustee objected to the debtor's discharge, and a trial was set. The debtor then amended his petition to disclose the transfer of the business assets to a third party. Even at trial, the debtor's explanations of the business and the transfers were not clear, and it was only at trial that the debtor and his accountant first referenced a CD containing many additional business records. The court continued the trial to give the trustee an opportunity to review the CD. At the continued trial, the trustee held up a large folder of business records that had only recently been produced. Upon questioning of the debtor about the records, it was still not clear whether the records were complete.

In deciding whether to deny the debtor's discharge, the Court began its analysis by pointing out the age-old adage that bankruptcy relief is designed to give honest but unfortunate debtors a fresh start. The Court added that the Fourth Circuit Court of Appeals has ruled that the right to a fresh start depends upon an honest and forthright invocation of the Bankruptcy Code's protections, including compliance with the statutory duties to fully and accurately disclose one's finances and to cooperate with the trustee in providing a complete inventory of assets and any related records. The Court then focused its attention to Section 727 of the code, which provides grounds for a discharge to be withheld from debtors playing "fast and loose" with their duties under the Code.

The trustee invoked three independent grounds for denial of discharge under Section 727: a false oath or account under §727(a)(4)(A); knowingly or fraudulently withholding recorded information under §727(a)(4)(D); and failure to explain loss of assets under §727(a)(5). The trustee had to prove by a preponderance of the evidence that the debtor was not entitled to a discharge before the burden could shift to the debtor to provide satisfactory, explanatory evidence in favor of discharge.

Count 1: §727(a)(4)(A) False Oath or Account. The Court unpacked the five statutory elements of §727(a)(4)(A) that must be proven in order to prevail on a discharge objection: (1) the debtor made a statement under oath; (2) the statement was false; (3) the debtor knew the statement was false; (4) the debtor made the statement with fraudulent intent; and (5) the statement related to a material matter to the bankruptcy case. For the first element, the Court cited case precedent establishing that a debtor's petition, schedules, and statements filed in the case as well as statements made at a 341 meeting and answers to interrogatories all constitute statements under oath for the purposes of §727. The bankruptcy petition, schedules, and statements are signed under penalty of perjury, so even an omission in the debtor's sworn schedules and statements constitutes a statement under oath. Thus, the Court concluded that the first element was easily met after finding that the debtor's petition, schedules, statements, amendments, and testimony at the 341 meeting, at a 2004 exam, and at trial, as well as his answers to interrogatories, were all statements made under oath.

The Court found the second and third elements—that the statement was false and the debtor knew it—were met. The bankruptcy schedules and statements specifically ask debtors to disclose ownership interests in businesses held at any time within six years of filing, as well as any transfers of assets. The debtor omitted the business interest and the transfer of the business interest, and then he omitted the transfer in his first amended statements. Furthermore, in his second amended statements, he disclosed the transfer but listed a false transferee. By responding that he had no ownership interests in a business within six years of filing and that he had not transferred any interests, the debtor made a false statement. Further, the debtor knew his statements were false because he obviously knew his business existed and what happened to its assets because it had been his primary source of income. The Court found that such significant omissions could not be the product of a simple mistake.

The Court found that the fourth element—that the false statements were made with intent to defraud—was met. The Court applied the definition of fraudulent intent as a material representation or omission the debtor knows to be false and will cause an erroneous impression. The Court observed that reckless indifference for the truth constitutes fraudulent intent. The Court also noted that fraudulent intent may be proven by circumstantial evidence or by inferences drawn from a course of conduct, and that it depends largely on the credibility and demeanor of the debtor. Because the debtor concealed the business interest and the transfer thereof, and, once exposed, amended his bankruptcy petition to list a false party as the transferee instead of the true party (his brother), it is apparent that the debtor intended to defraud the Court in order to protect his brother from an avoidable insider preference. Further, over a year after the petition date, interrogatories, depositions, and trial had yet to elucidate the full financial circumstances of the business and its transfer. Thus, the Court concluded that the debtor's credibility had proven suspect and his statements had been made with intent to deceive.

Finally, the Court found that the fifth element was met, based upon the rule that a false statement relates to a material matter when it concerns the existence and disposition of a debtor's property. The debtor's false statements related to his ownership interest in a company and the pre-petition transfer of that company, which implicated a possible insider preference or fraudulent conveyance. Therefore, the Court concluded that the debtor's statements related to a material matter.

Count II: §727(a)(4)(D) Knowingly and Fraudulently Withheld Recorded Information. Discharge may be denied under §727(a)(4)(D) if the trustee shows evidence that (1) the debtor withheld documents (2) in connection with the case (3) from an officer of the estate entitled to possession, (4) he did so knowingly and fraudulently, and (5) the documents are related to his property or financial affairs. Based on the facts described above, the Court concluded that these elements were satisfied because the debtor knew about the business records on the CD, he knew about the Trustee's request for business records, he knew the trustee made the requests as an officer of the estate in connection with the case, yet he did not provide the business records until he was brought to court for trial after spending over a year letting the trustee "go fish".

Count III: §727(a)(5) Failure to Explain Loss of Assets. Under §727 (a)(5), discharge should be denied if the debtor fails to provide a reasonable and credible explanation for a loss of assets. The trustee must show that the debtor owned substantial assets not too remote from the petition date and no longer had those assets thereafter. The Court has discretion as to whether the debtor's explanation is satisfactory, and discharge may be denied if the debtor has no records to corroborate his testimony. The Court found that, even after trial, the debtor had not provided records revealing what the business assets were and their current status.

For all of these reasons, the Court denied the debtor's discharge under §727(a)(4)(A), (a)(4)(D), and (a)(5) because the elements of each count were met by the evidence presented and the debtor provided no explanation favoring discharge.

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Eastern District Case Summaries

By Matthew Houston, Lauren Golden and Ike Johnston

***In re Godley (Godley v. Open Grounds Farm, Inc.)*, Case No. 12-00263 (Bankr. E.D.N.C. Feb. 5, 2014) (Doub, J.)**

Issue: Whether a trustee can avoid, pursuant to 11 U.S.C. § 545(3), a statutory landlord's lien for rent arising pursuant to N.C. Gen. Stat. § 42-15 as to certain crops, and therefore recover the value of the avoided lien from the landlord, when the debt underlying the lien has been paid as of the date of the debtor's bankruptcy filing?

Short Answer: No. Where a statutory lien is extinguished by payment prior to the filing of a debtor's bankruptcy petition, the statutory lien is no longer "fixed," and therefore neither the debtor nor trustee may recover the value of the lien.

Summary: The debtors, along with the trustee in a Chapter 12 bankruptcy case, filed a motion for summary judgment on their complaint pursuant to 11 U.S.C. § 545(3) to recover $587,340.00 paid to the defendant to satisfy a landlord's lien. On January 19, 2010, the husband-debtor executed a one-year farm lease with the defendant, which expired on December 15, 2010, and required the debtors to pay $1,037,432.00 in rent. The debtors paid approximately half of the balance, but failed to pay $587,340.00. Because the defendant-landlord obtained both a statutory landlord's lien pursuant to N.C. Gen. Stat. § 42-15 and a consensual lien on the debtor's crops pursuant to the terms of the lease, the debtors instructed the milling company to which they sold their crops to pay proceeds from their sales directly to the defendant. The milling company did so until the entire balance due under the lease was paid in October 2010.

On May 23, 2011, the debtors filed the aforementioned Chapter 12 petition, and, subsequently, the plaintiffs filed their adversary proceeding complaint against the landlord. In denying the plaintiffs' motion for summary judgment and, instead, granting summary judgment for the landlord, the court reasoned that the plain language of § 545(3) allows avoidance only of the "fixing" of a statutory lien. The court noted that, in this case, the landlord's lien, pursuant to N.C. Gen. Stat. § 42-15, was extinguished pre-petition when the full balance was paid approximately seven months prior to the debtors' bankruptcy. As a result, there was no lien "fixing" to avoid, as the lien had already been both "fixed" and satisfied. The plaintiffs argued in the alternative that 11 U.S.C. § 544(a)(1) allowed the plaintiffs to avoid the consensual lien created by the lease. For similar reasons - namely, that the lease was paid in full and had expired prior to the bankruptcy petition - the court concluded that there was no valid lien to set aside in favor of the trustee's hypothetical lien creditor. As a result, the court granted summary judgment in favor of the landlord-defendant.

***In re Dew*, 13-02284 (Bankr. E.D.N.C. March 10, 2014) (Doub, J.)**

Issue: Whether a debtor's failure to properly maintain financial records, failure to adequately identify collateral for promissory notes, and failure to maintain business records constituted gross mismanagement sufficient to justify the appointment of a trustee in a Chapter 11 proceeding pursuant to 11 U.S.C. § 1104(a)(1)?

Short Answer: Yes. When a debtor acts with a reckless disregard for the interest of creditors, the appointment of a Chapter 11 trustee is justified under 11 U.S.C. § 1104(a)(1).

Summary: On April 8, 2013, the debtors filed a Chapter 11 petition, and a Creditors' Committee was appointed on May 10, 2013. The debtors were in the business of selling and renting mobile homes for a mobile home park. On October 15, 2013, the Creditors' Committee filed a motion requesting the appointment of a Chapter 11 trustee. In support of its motion, the Committee argued that the debtors had solicited investments from their creditors with promises of first liens on certain mobile homes under terms requiring the debtors to make interest-only payments until a single balloon payment under each note. The Committee noted that the debtors never made principal payments on the notes and, further, that they sold mobile homes that had been pledged as collateral. In reviewing the Committee's motion, the court noted that, when testifying, the debtors were unable to identify the mobile homes that were supposedly pledged as collateral and were unable to account for financial reporting discrepancies. The debtors also failed to list all of their real property assets in their schedules as required.

In light of these points, the court concluded that the debtors acted "with at least a reckless disregard of the interest of the Creditors which amounts to gross mismanagement." As a result, a Chapter 11 trustee was justified pursuant to 11 U.S.C. § 1104(a)(1).

***In re Henry L. Anderson, Jr.*, 10-00809 (Bankr. E.D.N.C. Feb. 14, 2014) (Doub, J.)**

Issue: Whether the BAPCPA version or the BTCA version of section 724(b)(2) applies to debtors' attorneys' fees incurred in a Chapter 11 proceeding prior to its conversion to a Chapter 7 proceeding.

Short Answer: The BTCA version of § 724(b)(2) applies to debtors' attorneys' fees incurred during a Chapter 11 proceeding prior to its conversion to a Chapter 7, such that those fees are classified as a general unsecured claim rather than a cost of administration.

Summary: On February 3, 2010, the debtor filed a Chapter 11 bankruptcy petition, which was subsequently converted to a Chapter 7 proceeding. After the court approved interim compensation to the debtor's counsel, the trustee filed a motion in aid of distribution to determine the manner in which funds should be distributed from the debtor's estate. In the motion in aid of distribution, the trustee argued that 11 U.S.C. § 724(b)(2), as amended by the Bankruptcy Technical Corrections Act of 2010 ("BTCA"), governed distribution of the $185,430.21 owed to the debtor's counsel incurred during the original Chapter 11 action. The debtor's counsel objected to the motion and argued that the language of 11 U.S.C. § 724(b)(2) in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") should govern payment of such fees, with the difference being that the BAPCPA arguably allowed for payment of claims under § 502(a), while the BTCA limits such payments to expenses incurred in the Chapter 7 proceeding.

In rejecting the debtor's counsel's argument, the court noted that the BTCA version of the statute was effective as of the date on which the trustee filed the motion in aid of disbursement. The court further noted that there was no evidence in the text of the statute supporting a contrary interpretation and that there would be no manifest injustice to the debtor's counsel by refusing to allow payment of the fees incurred in the Chapter 11 proceeding. The court concluded that, because the debtor's counsel was operating under interim orders that were subject to judicial review, there was never a "fixed right" to payment of the fees. For similar reasons, the court rejected the debtor's counsel's argument that its Chapter 11 expenses should have priority over the Internal Revenue Service's tax liens. Thus, the objection was overruled, and the trustee's motion was granted.

***In re Grathwol (Robin Dale Grathwol and Ann F. Grathwol Living Trust v. Coastal Carolina Devs., Inc.)*, 505 B.R. 201 (AP No. 13-00024-8-SWH) (Bankr. E.D.N.C. Feb. 18, 2014) (Humrickhouse, J.)**

Issue: Whether a bankruptcy court has "related to" subject matter jurisdiction under 28 U.S.C.

§ 1334(b) for actions to recover amounts allegedly due to the bankruptcy estate when the debtor's plan does not provide for or is not otherwise contingent on the actions and any recovery would therefore have no effect on the administration of the debtor's estate?

Short Answer: No. Where a plan fails to provide for an action that is otherwise unrelated to the debtor's bankruptcy, the court does not have subject matter jurisdiction to hear such actions.

Summary: In January of 2012, the debtor filed a Chapter 11 petition, and her plan was confirmed on November 26, 2012. Subsequently, on February 8, 2013, the debtor and her related entities filed three adversary proceedings: 1) a suit brought by the debtor in her capacity as a shareholder against an entity in which she owned an interest, for malfeasance and breach of fiduciary duty; 2) a suit brought by the debtor and a living trust against the same company and other entities in which the debtor held an interest, for malfeasance and wasting of assets; and 3) a suit brought by a company wholly owned by the debtor against the same company noted above, in a breach of contract action. The defendants filed joint motions to dismiss the adversary proceedings for lack of subject matter jurisdiction.

The plaintiffs argued that the court had "related to" jurisdiction with respect to each proceeding because each case could "conceivably have any effect on the estate being administered in bankruptcy." The plaintiffs' rationale was that all potential recoveries from the suits would be good for the estate and all unsecured creditors. However, the creditors argued that the debtor's confirmed plan would pay unsecured creditors in full from other sources and that the plan had been substantially consummated with significant disbursements.

In granting the motions to dismiss, the court noted that because the plan failed to provide for the actions, because the plan had been confirmed and substantially consummated, and because the plan provided that it would pay unsecured creditors in full from other sources, there simply was no "related to" jurisdiction under § 1334(b).

***In re Gherini*, Case No. 11-08087 (Bankr. E.D.N.C. June 6, 2014) (Doub, J.)**

Issue: Whether the criminal prosecution of a debtor is prohibited by the automatic stay when the prosecution is related to acts constituting the basis for the debtor's bankruptcy and the investigation began prior to the debtor's bankruptcy?

Short Answer: No. 11 U.S.C. § 362(b)(1) clearly exempts such investigations and prosecutions from the scope of the automatic stay.

Summary: The debtor obtained funds from several investors for purposes of funding a business venture that never actually existed. One creditor discovered the fraud after paying $50,000 and requested that the local district attorney initiate an investigation. Subsequently, after the investigation began, the debtor filed a Chapter 7 petition. As a result, certain creditors filed a motion for determination as to whether the automatic stay applied to a criminal prosecution of the debtor on the basis of acts undertaken prior to his bankruptcy filing.

While the debtor argued that the prosecution should not be allowed on the basis that it was simply a way to require him to repay funds via restitution, which would be prohibited under judicially created exceptions to § 362(b)(1), the court noted that the investigation began well before the debtor's bankruptcy and that therefore the district attorney would be allowed to proceed with an arrest and prosecution.

***In Eng*, Case No. 13-02195 (Bankr. E.D.N.C. April 25, 2014) (Humrickhouse, J.)**

Issue: Whether improper impairment of a class of claims is a basis for denying confirmation of a debtor's plan for failure to propose the plan in good faith.

Short Answer: Yes.

Summary: The debtor agreed to purchase two gas stations and, in return, granted deeds of trust on both properties as well as liens on certain other property. The debtor subsequently defaulted on the underlying notes and filed a Chapter 11 petition on April 4, 2013. The debtor had only a single "impaired" class vote to accept its plan, with slightly more than $5,000 in unsecured claims. Only one creditor in the class voted on the plan, with a favorable vote representing approximately $915 of the class. The claims in the class represented approximately .25% of the total claims in the case.

In denying confirmation on the basis that the debtor failed to propose the plan in good faith, the court reasoned that the debtor had cash available to pay the claims of the creditors in the class in full, thereby reducing the need for such a class. Thus, the court concluded, it would be unfair and illogical to allow the favorable vote of such a small class to be the deciding vote allowing the cramdown of other creditors. Thus, the court denied confirmation of the plan because it was not proposed in good faith and granted the gas-station creditor's related motion for relief from stay, allowing it to proceed with recovery against several pieces of collateral.

***In Bissett Produce, Inc. (Derek & Matther Bissett Farms v. Bissett Produce Inc.)*, Case No. 13-000394 (Bankr. E.D.N.C. May 21, 2014) (Humrickhouse, J.)**

Issue: Whether a "grower" is required to give a PACA notice to preserve trust benefits prior to initiating a suit to recover under a PACA trust?

Short Answer: Yes.

Summary: The plaintiffs sold certain sweet potatoes to the defendant, the debtor, who then stored, cured, packeted, marketed, and sold the sweet potatoes as the agent for the plaintiffs. Under the Perishable Agricultural Commodities Act ("PACA"), such actions created a "trust" in the proceeds of the sale for the benefit of unpaid sellers and suppliers. However, in order to recover from the trust, sellers and suppliers are required to give notice within thirty days after the payment due date. The plaintiffs here failed to give written notice of any kind with regards to the PACA trust, and, as a result, the defendant-debtor moved to dismiss for failure to state a claim.

In support of their complaint, the plaintiffs argued that "growers," unlike suppliers and other parties, were implicitly exempted from the requirement to provide written notice with regards to the PACA trust under 7 U.S.C. § 499(e). The defendants argued, and the court agreed, however, that "growers" are no different than other suppliers for purposes of providing PACA trust notices and that the plaintiffs therefore erred by failing to provide notice of their intent to preserve funds under the PACA trust. The court looked at other case law discussing notices provided by growers to conclude that the definition of "grower" in applicable statutes does not exclude growers from the notice requirements and that, instead, growers are required to abide by such requirements. Thus, the court granted the defendant's motions to dismiss the plaintiffs' complaints for failure to state a claim.

***In re Danielle Fish*, Case No. 13-05783 (Bankr. E.D.N.C. Feb. 20, 2014) (Doub, J.)**

Issue: Whether a debtor's debts were primarily consumer debts when a portion of the debtor's debt was incurred without the debtor's knowledge?

Short Answer: The court will look at the totality of circumstances to determine whether the debtor's debts are primarily consumer debts. The court will also look at the number of consumer creditors, the number of non-consumer creditors, and the amount of consumer debt versus non-consumer debt.

Summary: The bankruptcy administrator filed a motion to dismiss pursuant to 11 U.S.C. § 707(b)(1). The parties stipulated that the total amount of the debtor's consumer debt was $331,577.73. In addition to this debt, the parties also stipulated that the debtor had four unsecured claims in the total amount of $31,896.38 that were incurred in the debtor's name jointly with her former spouse without the debtor's knowledge or consent. The parties also stipulated that the debtor did not have knowledge of the accounts and did not authorize the accounts to be opened or charged.

The bankruptcy administrator argued that the debtor's debts were primarily consumer debts and subject to § 707(b)(1). The debtor responded that her debts were not primarily consumer debts because if it was not for her former spouse incurring charges in her name without her knowledge she would not have filed a bankruptcy petition.

The court noted that the bankruptcy code does not explain how to determine whether debts are primarily consumer debts. The court explained three different tests that have been developed by case law. Some courts look to the amount of debt and conclude that where the consumer debt exceeds fifty percent (50%) of the total debt, the debts are primarily consumer debts. Other courts have held that consumer debts should be evaluated based on the amount of the debt and by the relative number of consumer debt claims. Yet other courts take a third approach by looking at the "totality of the circumstances."

The debtor urged the court to adopt a totality of the circumstances approach. She argued that, based on the totality of the circumstances, her debts were not primarily consumer debts because if it was not for her former spouse incurring charges in her name without her knowledge she would not have filed a bankruptcy petition. The court applied the totality of the circumstances approach and found that the debtor's debts were primarily consumer debts because both the amount of consumer debt and the amount of consumer claims exceeded the amount of non-consumer debt and non-consumer claims.

The parties stipulated that the debtor's case would be a presumed abuse if the debtor's income, expenses, and unsecured debts were evaluated in the formula set out in 11 U.S.C. § 707(b)(2)(A). Therefore, the court found that the debtor's case was a presumed abuse.

***Angell v. Larabee*, Case No. 12-00177 (Bankr. E.D.N.C. Apr. 7, 2014) (Doub, J.)**

Issue: Whether certain loan payments by the debtor were made in the ordinary course of business between the parties even though they deviated from the established pattern of payments?

Short Answer: No, the interest payments in question were substantially different in amount and timing from payments made prior to the challenged payments.

Summary: The trustee filed an adversary complaint setting forth three claims for relief for avoidance and recovery of preferential transfers. Prepetition, the debtor was obligated to the defendant for the repayment of a loan and made regular payments of approximately $1,800 each month through August 2009. The debtor missed the monthly payment in September, but it made a payment in October for the regular amount, $1,800. Then it missed the November and December payments.

Following a demand from the defendant, the debtor agreed to catch up the missed payments. The debtor paid roughly $5,500 in January, which corresponds to January's payment, September's payment, and November's payment. In February, the debtor made a payment of around $3,600, which corresponded to December's and February's payment. Then the debtor missed its March payment, made its April payment of $1,800, missed its May and June payments, and made its July payment. Altogether, following its first missed payment in September 2009, the debtor made five payments in an amount sufficient to cover eight months' worth of payments.

The trustee argued that these five payments constituted "catch up" payments requested by the defendant and did not follow the ordinary schedule or amount of payments from the debtor to the defendant. The defendant conceded that she was liable to the trustee for the overpayments in January and February that were in excess of the regular monthly amount. However, she asserted that the remaining amounts—that is, the first $1,800 of the January and February payments—were made in the ordinary course of business between the parties and were therefore protected from recovery under section 547(c)(2).

The court found that the so-called "catch up" payments in question were substantially different in amount and timing from payments made prior to the challenged period. The parties' departure from their ordinary course of business meant that even the base amounts of the January and February payment were preferences. Likewise, the April and July payments were outside of the ordinary course due to their timing, even though they were for the usual monthly amount. However, the court found that the October 2009 payment *was* made in the ordinary course; even though the debtor missed the September payment, the October payment was in the usual amount.

***In re Amerlink, Ltd.*, Case No. 09-01055 (Bankr. E.D.N.C. Mar. 3, 2014) (Doub, J.)**

Issue: Whether the trustee of a corporation in bankruptcy has the authority to waive the debtor corporation's attorney-client privilege with respect to communications that took place before the filing of the petition in bankruptcy even when the trustee is not a party to the underlying litigation?

Short Answer: Yes, the trustee's authority to waive the attorney-client privilege in a corporate chapter 7 case is broad. The trustee has full authority and discretion to determine if a waiver is appropriate. There is no legal precedent for any exceptions to the trustee's waiver authority.

Summary: The trustee filed a motion for authority to waive the debtor's attorney-client privilege in connection with a discovery dispute in a state court action among various insiders of the debtor. One insider, the former CEO and chairman of the board, had sued other board members and additional defendants, alleging a scheme to take over the debtor in connection with investments in or financing to the debtor. During the discovery process in the state court suit, a dispute arose between the parties as to the scope of the waiver of the debtor's attorney-client privilege. The defendants requested the plaintiff to produce documents from files on a server and two computers that were property of the bankruptcy estate but that remained in the plaintiff's possession and control. The plaintiff argued these documents were subject to the debtor's attorney-client privilege. The defendants argued that a waiver of a corporate debtor's attorney-client privilege is controlled exclusively by the trustee.

The plaintiff argued that the state court action was not brought by the trustee or a government agency on behalf of or in support of creditors. The plaintiff also argued that the trustee has not determined that the waiver is in the best interest of the creditors.

The court noted that in *CFTC v. Weintraub*, 471 U.S. 343 (1985), the United States Supreme Court unanimously held that the trustee of a corporation in bankruptcy has the authority to waive the debtor corporation's attorney-client privilege with respect to communications that took place before the filing of the petition in bankruptcy. This holding affirmed the broad authority of the trustee to waive the attorney-client privilege. The court also noted that no limitation of the waiver based on the identity of the litigants was expressed by the Supreme Court. Based on the Supreme Court's holding, the court affirmed that the trustee had the complete and exclusive authority to waive the corporate debtor's attorney-client privilege.

***In re McDonnell Horticulture, Inc.*, Case No. 12-09009-8-ATS (Bankr. E.D.N.C. Feb. 12, 2014) (Small, J.)**

Issue: Whether a creditor was a purchase money creditor and thus precluded from seeking a deficiency claim under North Carolina's anti-deficiency statute when the creditor did not own any real property that was conveyed to the debtor as part of a global asset sale?

Short Answer: Yes. The real property sale was an essential part of an integrated sale between the creditor and its entities as seller, and the debtor and its entities as buyer. The anti-deficiency statute, however, is broadly applied, and this transaction's complicated structure came within its reach.

Summary: The debtor operated a nursery business in Cameron, NC, and filed a chapter 11 petition in December 2012. Creditor Rippin & Stavin ("R&S") filed a proof of claim based on two notes, in the amounts of $1,000,000 and $1,648,048, arising from the sale of the nursery business by R&S and its related entities to the debtor and its related entities in 2003. What the debtor purchased was described as a "woody ornamental plant" growing business consisting of plant inventory, greenhouses, irrigation equipment, vehicles, associated agricultural equipment, and real property upon which the business was operated. That real property consisted of a 71-acre tract and a 144-acre tract, both of which were conveyed as part of the purchase to Claddagh Land Company, which, like the debtor, is owned by Patrick McDonnell. The total purchase price was $7 million. Over half of this amount was financed by Creditor Carolina Farm Credit ("CFC"), which took a first lien on the assets. Claddagh took title to the real property and granted two deeds of trust securing the notes to R&S. The 71-acre tract secured the $1,000,000 note, and the 144-acre tract secured the $1,648,048 note.

The debtor's plan proposed to treat the R&S claim as two claims: A $300,000 secured claim, and a $1,513,656.05 unsecured claim. After the plan was confirmed, creditor CFC filed a timely objection, arguing that the R&S deeds of trust were purchase money deeds of trust and that under North Carolina's anti-deficiency statute, N.C.G.S. § 45-21.38, R&S was precluded from asserting an unsecured claim against the debtor. The anti-deficiency statute provides that where deeds of trust are given to secure the balance of the purchase price for real property, "the mortgagee or trustee or holder of the notes secured by such mortgage or deed of trust shall not be entitled to a deficiency judgment on account of such mortgage, deed of trust or obligation secured by same."

R&S argued that because it did not own the own the real property or sell it to McDonnell, it "cannot be a purchase money creditor." CFC countered that the real property was part of a "global" sale of assets owned by R&S and its related entities, and the court agreed. The real property sale was an essential part of an integrated sale between R&S and its entities as seller, and the debtor and its entities as buyer. The court acknowledged that it "may seem unfair that the purchase money deeds of trust would prohibit deficiency claims for the entire transaction" given that the purchase agreement allocated only $720,000 of the purchase price to the real property; the statute, however, is "broadly applied," and this transaction's complicated structure came within its reach.

***Crampton v. Houseman*, AP No. 12-05310-8-SWH (Bankr. E.D.N.C. March 24, 2014) (Humrickhouse, J.)**

Issue: Whether the defendant waived her right to a jury trial of the claims against her by asserting her right to setoff as an affirmative defense?

Short Answer: Yes, pleading setoff as an affirmative defense essentially asserts a claim against the estate's right to recover from the defendant, thereby subjecting the defendant to the equitable jurisdiction of the bankruptcy court.

Summary: The chapter 7 trustee filed an adversary proceeding asserting fraudulent conveyance claims against the defendant, who was the non-filing spouse of the chapter 7 debtor. The trustee sought to recover all or part of multiple transfers to the defendant from the debtor, and from entities in which the debtor had an interest. In her answer, the defendant asserted her Seventh Amendment right to a jury trial. She did not assert any counterclaims, and did not file a proof of claim in the underlying bankruptcy case. She did, however, assert her right of "setoff" as an affirmative defense, which applied to every claim against her, with the possible exception of one. In addition, the defendant sought to establish a basis for "credit" against many of the challenged transfers, and asserted her entitlement to a constructive trust or lien on certain proceeds.

As a preliminary pre-trial matter, the court addressed the question of whether the defendant was entitled to a jury trial of the claims against her or whether she had, as the trustee argued, waived that right by reason of the nature of her affirmative defenses.

The parties agreed that a defendant who files a proof of claim against a bankruptcy estate "triggers the process of the allowance and disallowance of claims, thereby subjecting himself to the bankruptcy court's equitable power." The defendant had not done so, which in her view essentially ended the debate.

However, the trustee pointed out that courts apply that same rationale (including the EDNC, in *Murray v. Richmond Steel & Welding Co.*, 170 B.R. 868 (E.D.N.C. 1994)) to a defendant's filing of a counterclaim. From that point, the trustee argued, it follows that a defendant's assertion of setoff as an affirmative defense has the same effect and triggers that same claims allowance process. The court agreed with the persuasive authority provided by the trustee that a defendant pleading setoff as an affirmative defense "essentially asserts a claim against the estate's right to recover from the defendant," the financial repercussions of which are that it results in the defendant's claim being "treated as a secured claim, resulting in his claim, if proven and allowed, being satisfied in full, and in real dollars as opposed to 'tiny bankruptcy dollars.'" In this case, in addition to claiming entitlement to setoff and credit, the defendant also sought a constructive trust or lien with respect to a 40% interest in one of the debtor's companies, all of which together operated to subject her to the equitable jurisdiction of the bankruptcy court.

***In re Barefoot*, Case No. 12-02160 (Bankr. E.D.N.C. March 18, 2014) (Doub, J.)**

Issue: Whether the Farm Service Agency ("FSA") could amend its proof of claim to increase its secured claim from $70,000 to $100,000 when the amended claim was filed a year after the debtor's Ch. 12 plan was confirmed and the FSA had taken no other steps to assert or preserve its right to setoff.

Short Answer: No. Creditors must assert the right of setoff in a "timely and accurate manner 'so as to permit the debtor to timely file a plan and other creditors to decide whether to object to the plan.'" These considerations are especially important in a Ch. 12 case.

Summary: The debtor was a farmer who owed FSA approximately $300,000 based on a prepetition loan. Also prepetition, the debtor became entitled to an $83,300 refund from a separate federal agency, the Commodity Credit Corp. ("CCC"). The debtor filed his Ch. 12 petition on March 20, 2012. On May 8, 2012, FSA filed a proof of claim asserting a secured claim of about $70,000. The court confirmed the debtor's Ch. 12 plan a few months later.

Six months after the plan was confirmed, FSA discovered a $30,000 mistake in the calculation of the debtor's refund from CCC. The debtor should have been entitled to around $50,000 rather than $80,000. Six months after it discovered the error, FSA filed an amended proof of claim seeking to increase its secured claim by $30,000. This amended proof of claim was filed a year after the plan was confirmed and sixteen months after the original proof of claim.

By way of background, the court reviewed several sections of the Code. Section 502 governs objections to claims and the burden-shifting analysis thereof. Section 553 provides that "[e]xcept [as otherwise provided] this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose [prepetition] against a claim of such creditor against the debtor that [also] arose [prepetition]." Section 362(a)(7) stays the exercise of the right of setoff.

The court also reviewed a prior case involving similar facts. In *In re Britton*, 83 B.R. 914 (Bankr. E.D.N.C. 1988), the court denied the government's motion to lift the automatic stay to allow setoff. In *Britton*, the government had previously filed a proof of claim that neglected to assert the right of setoff. The *Britton* court stated that "in Chapter 11 and Chapter 12 cases, the burden is on the USA to timely and properly file its proof of claim asserting the right of set-off and to seek a lifting of the automatic stay to permit it to exercise this right." *Id.* at 921.

In the instant case, the court found that "[t]he Debtor and other creditors have relied on the confirmed Plan[, which was] confirmed relying on a secured claim of FSA in the amount of $69,970.16, not $101,848.73." The court also found that the language of the FSA's proof of claim did not clearly assert the right to setoff, and the agency that actually made the overpayment—CCC—didn't even file a proof of claim. Finally, the court also found that neither agency sought relief from the stay in connection with a right of setoff. For these reasons, the court denied FSA's amended claim. The court did not reach the issue of whether FSA and CCC were a "unitary creditor" for purposes of the "mutuality" requirement for establishing a right to setoff.

***In re Gatlin*, Case No. 14-00242-5-RDD (Bankr. E.D.N.C. Feb. 18, 2014) (Doub, J.)**

Issue: Whether the automatic stay will prevent a creditor from conducting a foreclosure sale upon the debtor's third bankruptcy filing within the prior one-year period.

Short Answer: No. Pursuant to 11 U.S.C. § 362(c)(4)(A)(i), no automatic stay went into effect upon the filing of the debtor's third petition. The foreclosure sale was properly completed upon the expiration of the ten-day statutory upset bid period and could not be set aside.

Summary: The debtor filed a third bankruptcy petition within a one-year period. Ten days earlier, a foreclosure sale had taken place at which the secured creditor entered the high bid. No upset bids were received. The debtor filed a motion for the imposition of the automatic stay pursuant to 11 U.S.C. § 362(c)(4)(B). The secured creditor objected to the motion to impose the stay.

Under N.C. Gen. Stat. § 45-21.27, once the foreclosure trustee conducts the sale of the foreclosed real property and the ten-day upset bid period expires, the rights of the parties to the sale become fixed. Under North Carolina law, a sale of real property cannot be set aside after the ten-day upset bid period has expired. In most cases, if the borrower files bankruptcy before the end of the upset bid period, the automatic stay will prevent a creditor from conducting a foreclosure sale. However, the instant case was the debtor's third filing within the prior one-year period, and therefore no automatic stay went into effect upon the filing of the petition. 11 U.S.C. § 362(c)(4)(A)(i) The Court determined that because the automatic stay never went into effect, the foreclosure sale was properly completed and the sale of the property could not be set aside. The Court granted to the motion to impose the automatic stay as to all creditors except for the creditor that completed the foreclosure.

***In re Youngkin*, Case No. 12-08391-8-RDD (Bankr. E.D.N.C. Feb. 27, 2014) (Doub, J.)**

Issue: Whether various monthly statement letters, damage repair letters, and letters including collection language sent to a debtor following a Chapter 7 discharge constituted a willful violation of the discharge injunction warranting sanctions.

Short Answer: Yes. The cumulative effect and impact of the letters and collection language by the creditor after the debtor had clearly communicated to the creditor on numerous occasions the intention to surrender the property constituted a willful violation of the discharge injunction and warranted sanctions.

Summary: Following the debtor's Chapter 7 discharge, the debtor continued to receive many letters from a creditor regarding a property that had been surrendered pursuant to the Chapter 7 Individual's Statement of Intention. Several of the letters contained a disclaimer that indicated that the letters were informational notices that were not an attempt to collect a debt if the loan was discharged in a bankruptcy proceeding. After several of the letters, counsel for the debtor sent three written requests to cease correspondence, notices, insurance letters, etc., as the debtor was surrendering the property and had no interest in keeping the property. The creditor continued to send letters, even after the written requests from debtor's counsel. The next letter received was a monthly informational statement that included collection language that if a payment was not received by the stated date, then the creditor might seek possession of the collateral. The creditor sent a further letter assigning an account representative and later letters were sent for repair expenses for the property and stated that the purpose of the letter was to collect a debt. The debtor testified at hearing that she was 72 years old and that the continuous written communications, collection efforts, and harassment by the creditor had caused her significant stress, anxiety, and emotional harm. She suffered from loss of sleep and appetite, and she had also missed work. The debtor sought sanctions and attorney fees for willful violation of the automatic stay under 11 U.S.C. § 362(k).

The filing of a petition in bankruptcy generally acts as an automatic stay of any act to collect a debt that arose prepetition. 11 U.S.C. § 362(a)(6) The Bankruptcy Code also provides that any individual injured by any willful violation of the automatic stay shall recover actual damages and, in appropriate circumstances, punitive damages. 11 U.S.C. § 362(k)(1) The Bankruptcy Court for the Eastern District of North Carolina has held that willfulness does not refer to the intent to violate the automatic stay, but rather refers to the intent to commit the act that violates the automatic stay. A discharge in a bankruptcy case operates as an injunction against an act to collect a debt discharged pursuant to 11 U.S.C. § 524(a). Section § 524(a) may be enforced through the court's contempt power under 11 U.S.C. § 105(a).

The Court found that the letter assigning an account representative and the letters for repair expenses were willful violations of the discharge injunction. The debtor's actions in sending three warning letters via her attorney and stating in the Chapter 7 Individual Debtor's Statement of Intention that she was surrendering the property gave the creditor clear notification that the debtor was no longer interested in keeping the property. The letters received from the creditor and the letters sent by the debtor's attorney proved by a preponderance of the evidence that the violation of the discharge injunction was willful. The Court imposed sanctions of $3,500 in attorney fees to debtor's counsel, $1,500 in actual damages to the debtor, and $2,500 of civil sanctions to the U.S. Bankruptcy Court.

***In re Morton*, Case No. 13-06090-8-RDD (Bankr. E.D.N.C. Feb. 28, 2014) (Doub, J.)**

Issue: Whether debtors' Motion to Convert Case under Chapter 7 to a Case under Chapter 13 should be allowed unless the debtors' bad faith or conduct would disqualify the debtor from Chapter 13 relief.

Short Answer: Yes. Under 11 U.S.C. § 706(a), a debtor may convert a case under Chapter 7 to another chapter at any time if not previously converted; however, a court may deny the motion to convert if the debtor's bad faith or conduct would disqualify the debtor from relief.

Summary: Chapter 7 debtors filed a Motion to Convert to Chapter 13; the trustee objected. The trustee had discovered at the 341 meeting that the debtors had submitted an bank statement for August 2012 instead of August 2013 as part of the submission of bank statements covering the ninety days prior to the petition date. The debtors subsequently submitted the correct bank statement for August 2013, and the trustee discovered that there was a large deposit in the amount of $4,200.00 which could have resulted in a presumption of abuse pursuant to 11 U.S.C. § 707(b)(2). At hearing, the debtor testified that he had mistakenly sent the incorrect bank statement to his attorney and had not noticed that he had submitted the incorrect bank statement to the trustee. The large deposit was on account of a construction project.

The Court found that the debtors showed by a preponderance of the evidence that the bankruptcy filing was made in good faith because the submission of an incorrect bank statement was a mistake committed by both the debtors and debtors' counsel. The Court granted the Motion to Convert to Chapter 13 as there was no bad faith basis which would disqualify the debtor from the requested relief to convert. [*Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007)] The Court further directed that, going forward, the case should not be dismissed under Chapter 13 if the debtors failed to carry out a successful Chapter 13 case but should instead be converted back to Chapter 7 to be administered by the Chapter 7 trustee.

***In re Green*, Case No. 13-02513-8-RDD (Bankr. E.D.N.C. Mar. 13, 2014) (Doub, J.)**

Issue: Whether the repeated failure to provide proper service along with the filing of a frivolous motion constituted bad faith actions warranting sanctions.

Short Answer: Yes. The debtor's frivolous motion lacked any legitimate factual or legal support, and the debtor repeatedly failed to properly serve the motion. Together, this constituted bad faith action and warranted sanctions.

Summary: A *pro se* debtor filed a Motion for Sanctions for Violation of the Automatic Stay and later a Motion to Leave the Court. Deficiency notices were issued by the Court for both motions due to failure to serve the motions pursuant to Rules 7004(b) and 9014(a) of the Federal Rules of Bankruptcy Procedure. After the debtor's failure to cure the deficiencies, the Court issued a Show Cause as to why the case should not be dismissed or other sanctions imposed based on the debtor's failure to cure deficiencies. At hearing on the Show Cause, the debtor appeared *pro se* and was not able to produce evidence of proper service of the motions under the bankruptcy rules. Further, the debtor had attempted service on five parties just three days before the hearing, which is insufficient notice under the rules.

The Court concluded that the motions were frivolous in that there was no legitimate factual or legal support and they were not based on a good faith argument for the extension or reversal of existing law. The Court found by clear and convincing evidence that the debtor had acted in bad faith and abused the judicial process by taking several actions that constituted sanctionable conduct under *Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991), and 11 U.S.C. § 105(a), including failure to cure deficiencies, failure to have a good faith legal argument, failure to have legitimate factual and legal bases for the motions, and attempting to serve parties only three days before hearing. The Court sanctioned the debtor $1,500.00 for the attorney's fees incurred by the five parties who were served only three days prior to the hearing and who then hired counsel to appear at the hearing.

***In re Davis*, Case No. 13-02267-8-RDD (Bankr. E.D.N.C. Apr. 1, 2014) (Doub, J.)**

Issue: Whether the doctrine of unclean hands prevents a party from obtaining equitable relief if the party has been guilty of any inequitable or wrongful conduct with respect to the transaction or subject matter of the litigation.

Short Answer: Yes. The creditor's actions of offering mortgage assistance before and after filing a Motion for Relief from Stay unfairly gave the debtors hope and demonstrated a lack of good faith; thus, the creditor's unclean hands prevented the creditor from receiving equitable relief from the automatic stay.

Summary: Four days prior to filing a motion for relief from the automatic stay, the creditor sent to the debtors two letters offering mortgage assistance through several potential options. Four days after the initial letters, the creditor filed a motion for relief from the automatic stay that contradicted the offers of assistance made in the letters. Later, the creditor sent the debtors two additional letters regarding a mortgage assistance program. The two further letters contained incorrect information regarding the debtors' application for mortgage assistance, which suggested that the creditor had not fully considered the debtors' application.

The Court noted that because bankruptcy courts are courts of equity, a court could not consider a motion in isolation. Instead, the court should consider the context that existed at the time the motion was filed. The context in which the motion was filed and the reasonable expectations of the debtors upon receiving letters from the creditor were relevant considerations as to whether the creditor acted wrongfully or inequitably. The Court found that the creditor was had committed inequitable and wrongful conduct with respect to the motion for relief from the automatic stay because it requested relief from the stay while at the same time offering mortgage modification assistance. Importantly, there was a close nexus between the creditor's inequitable and wrongful conduct and the subject of the motion. Thus, unclean hands prevented the creditor from obtaining equitable relief of having the stay lifted, and the Court denied the motion for relief from stay.

***Erin Enterprises, Ltd. v. Presidential Bank, FSB*, A.P. No. 13-00033-8-RDD (Bankr. E.D.N.C. Jun. 12, 2014) (Doub, J.)**

Issue: Whether a deed that misspelled the grantee's name effectuated a valid property transfer.

Short Answer: Yes. Under North Carolina law, a deed is effective to convey title even if the grantee's name is misspelled.

Summary: Pre-petition, plaintiff conveyed a deed which included an error in the name of the grantee. The error was a transposition of two roman numerals. The transposition of the roman numerals created the name of a legal entity that did not exist. After that deed was recorded, plaintiff-debtor filed its first Ch. 11 bankruptcy. While the first Ch. 11 case was pending, the debtor-plaintiff attempted to correct the misspelling by filing a correction deed. The first Ch. 11 case was ultimately substantially compensated. Later, following a foreclosure of the property in question, the debtor-plaintiff filed the current chapter 11 case. Then the debtor-plaintiff commenced an adversary proceeding that included a claim for relief relating to the property. In the complaint, the plaintiff alleged that the filing of the correction deed during the previous case was a violation of the automatic stay and thus was void. The Plaintiff argued that it could therefore recover the property or the value of the property for the benefit of the estate.

The North Carolina Supreme Court has determined that a deed may transfer title to a legal entity even if the entity is misnamed on the deed and the deed identifies a legal entity that does not exist. Furthermore, the North Carolina Supreme Court has determined that a deed is valid notwithstanding the erroneous description of a grantee. The Court found that the transposition of the two roman numerals described a legal entity that did not exist. This ambiguity could be clarified by parol evidence. The Court further found that even though the original deed misidentified the grantee, it effectively conveyed the property to the grantee. At the time the debtor-plaintiff recorded the correction deed, it had no legal or equitable interest in the property. Thus, the correction deed was without legal effect and was not a violation of the automatic stay.

***In re Morris*, Case No. 12-03694-8-SWH (Bankr. E.D.N.C. Jul. 31, 2014) (Humrickhouse, J.)**

Issue: Whether a plan modification under Chapter 13 may provide for 60 monthly payments from the first payment following plan confirmation, when the confirmation had been delayed for 15 months.

Short Answer: Yes. A Chapter 13 plan that is modified under 11 U.S.C. § 1329 must be completed within 60 months of the confirmation of the original plan. 11 U.S.C. § 1329(c)

Summary: The debtor filed a motion to modify plan to a 75-month payment plan. The trustee objected on the basis that the plan should not provide for more than 60 months of payments. The debtor's proposed modification provided for a total of 75 months; however, only 60 of these payments were to be made following confirmation of the original plan. The confirmation of the plan had been delayed for 15 months due to an adversary proceeding that impacted confirmation. The procedural delays associated with the adversary proceeding were not attributable to the debtor's delay or any bad faith.

A Chapter 13 plan that is modified may not provide for payments beyond the "applicable period". The "applicable period" begins when the first payment under the original confirmed plan was due. The Fourth Circuit held that the period cited in § 1329(c) begins with the first payment made under a confirmed plan and not the first payment due under a proposed plan (which is typically due within one month of the filing of the petition). [*West v. Costen*, 826 F.2d 1376 (4th Cir. 1987)] The Court held that under 11 U.S.C. § 1329(c), a plan may be modified if it provides that payments be completed within 60 months of the confirmation of the original plan.

The Court further found that the modified plan was proposed in good faith because the procedural delays associated with confirming the original plan were not the debtor's fault and there was no bad faith action on the part of the debtor in the confirmation process or any effort by the debtor to take advantage of the bankruptcy system by back loading payments.

***In re Smith*, Case No. 14-00310-5-DMW (Bankr. E.D.N.C. Aug. 12, 2014) (Warren, J.)**

Issue: Whether a debtor's good intent that she and her deceased husband take title to their residence as tenants by the entirety entitles her to a $60,000 exemption even when record title was only in the name of her late husband.

Short Answer: Yes. Common law rules regarding ownership of real property focus on giving effect to the intent of the parties at the time of the conveyance. Thus, where a debtor presented credible evidence that she and her late husband intended to own their residence as tenants by the entireties, she would be allowed the $60,000 exemption regardless of the deed to her late husband only.

Summary: A seventy-one-year-old debtor claimed a $59,500 exemption in a house and lot pursuant to N.C. Gen. Stat. § 1C-1601(a)(1). The debtor's spouse was deceased, and the property was titled in the name of the deceased spouse only. The trustee objected on the basis that there was no indication that that debtor had an ownership interest in the property prior to the deceased spouse's death. The trustee argued that the exemption should thus be limited to $35,000.

The debtor testified at hearing that the deceased spouse purchased the property as a family home and that both the debtor and the deceased spouse believed that the property belonged to both of them. At no time did the debtor intend that her contribution to payments on the house were to be a gift to her deceased spouse. The debtor made payments on a note drafted directly from her salary, paid for upkeep on the property, and paid ad valorem taxes since 1962. The acquisition of the property was facilitated by the debtor pledging her marital interest as security for a mortgage on the property as evidenced by a deed of trust executed at the time of the purchase of the property and the conveyance to the deceased spouse. The deceased spouse believed that the property was owned jointly as tenants by the entirety as evidenced in his Last Will and Testament.

Under N.C. Gen. Stat. § 1C-1601(a)(1), a debtor may claim an exemption of up to $60,000 if the debtor is age 65 or older and unmarried, so long as the property was previously owned as tenants by the entirety or as a joint tenants with rights of survivorship and the former co-owner of the property is deceased. Under North Carolina law, common law rules regarding property ownership are focused on determining the beneficial ownership of property acquired during marriage by giving effect to what was intended at the time the property was acquired. The Court found, based on the debtor's credible testimony, that it was both the intent of the debtor and the deceased spouse that title to the property be held as tenants by the entirety. Therefore, the debtor was entitled to an exemption of up to $60,000 under N.C. Gen. Stat. § 1C-1601(a)(1), and the trustee's objection was overruled.

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Middle District Case Summaries

By Jennifer B. Lyday

***Skerlak v. Oak Harbor Capital III, LLC (In re Skerlak)*, Case No.13-10213, Adv. Pro. No. 13–02051, 2014 WL 1153972 (Bankr. M.D.N.C. Mar. 20, 2014) (James, J.)**

Issue: Whether filing a proof of claim constituted collection activity under the North Carolina Collection Agency Act.

Short Answer: No. Filing a proof of claim in a bankruptcy case does not constitute debt collection activity.

Summary: A chapter 13 debtor claimed a creditor violated the North Carolina Collection Agency Act ("NCCAA") by filing a proof of claim in the debtor's bankruptcy case without first obtaining a North Carolina license as a debt collector and by failing to attach proper documentation to the proof of claim. The creditor amended the proof of claim to attach additional documentation and filed a motion to dismiss the complaint and for attorneys' fees.

The NCCAA defines "collection agency" to include any person who solicits delinquent claims that are owed or due and any person who enforces or prosecutes such claims. N.C. Gen. Stat. § 58–70–15(a). The statute defines "debt buyer" to include entities that engage in the business of purchasing delinquent consumer debt for collection purposes. *Id.* § 58–70–15(b)(4). The statute prohibits collection agencies from using unfair practices while engaging in debt collection, N.C. Gen. Stat. § 58-70-115(5), and prohibits collecting a debt without valid documentation. *Id.* § 58–70–150.

The Bankruptcy Court for the Eastern District of North Carolina held in *In re Nussman*, 501 B.R. 297, 301–02 (Bankr. E.D.N.C. 2013), that "filing a proof of claim does not trigger N.C.G.S. 58–70–150." This decision reaffirmed *In re Jenkins*, 456 B.R. 236, 240 (Bankr. E.D.N.C. 2011), in which the court "refused to equate filing a proof of claim with collection activity." Also, a majority of courts have held that filing a proof of claim in a bankruptcy case does not constitute "debt collection activity" under the Fair Debt Collection Practices Act ("FDCPA"). The court agreed with the reasoning of these other courts and noted that construing a proof of claim as debt collection activity would be contrary to 11 U.S.C. § 362(a)(6), which imposes a stay on attempts to collect pre-petition debt upon the filing of a bankruptcy petition.

The court dismissed the complaint but denied the creditor's request for attorney's fees because, at the time the complaint was filed, *Nussman* had not been decided and there was a split among bankruptcy courts regarding whether the filing of a proof of claim constituted a debt collection activity under the FDCPA and its state law counterparts.

***In re Greco*, Case No. 12-51497, 2014 WL 1168507 (Bankr. M.D.N.C. Mar. 21, 2014) (Aron, J.)**

Issue: Whether a secured creditor's deficiency claim should be disallowed based upon the amount of its credit bid at foreclosure, when compared to the value of the property.

Short Answer: Plaintiffs' objection to the bank's unsecured deficiency claim under N.C. Gen. Stat. § 45–21.36 was denied where the bank's bid was not substantially less than the true value of the debtors' property.

Summary: A bank held a duly-perfected mortgage and deed of trust that encumbered chapter 13 debtors' commercial property to secure a $600,000.00 debt. Debtors put the commercial property on the market initially for $850,000.00. The price was eventually reduced to $750,000.00. The only offer the debtors received for the property was for $675,000.00, which the debtors turned down. When the debtors filed for bankruptcy protection, the remaining debt was $596,236.24. In their proposed plan, the debtors valued the property at $739,970.00 based upon a county tax valuation.

The bank filed a motion for relief from stay. The debtors did not appear or object. The court granted relief from stay, and the bank purchased the property for $350,000.00 through a credit bid at a foreclosure sale. Thereafter, the bank filed an amended proof of claim reflecting a deficiency claim of $267,948.64 still secured by other collateral. The debtors objected to the bank's proof of claim under N.C. Gen. Stat. § 45–21.36, arguing that the bank's bid at the foreclosure sale was "substantially less" than the "true value" of the property.

The amount of a creditor's bid does not establish the "true value" of the property for the purposes of applying N.C. Gen. Stat. § 45–21.36. The court therefore looked to testimony of the debtor, the tax records, and the testimony of three expert witnesses. None of the experts could account for the amount of the county's tax valuation, and two of the experts testified that the fair market value of the property had been no more than $310,000 at the time of the foreclosure sale.

In *Blue Ridge Sav. Bank, Inc. v. Mitchell*, 721 S.E.2d 322, 325 (N.C. Ct. App. 2012), aff'd, 366 N.C. 331, 734 S.E.2d 572 (2012), the North Carolina Court of Appeals applied a guideline that "a bid that was twenty percent less than the appraised value of the property was 'substantially less' than the property's true value." Applying *Mitchell*, the court denied the debtors' objection because the property was worth less than $437,500, the number that, when reduced by 20%, equals $350,000, the amount of the bank's credit bid.

***In re Norman*, Case No. 14-80039, (Bankr. M.D.N.C. Apr. 1, 2014) (Kahn, J.)**

Issue: Whether the presumption of undue hardship under a reaffirmation agreement was rebutted when it created negative monthly net income for the debtors and contained potentially unknown charges.

Short Answer: The debtors' lease reaffirmation agreement with a car dealer imposed an undue hardship where the agreement created negative monthly net income for the debtors and reaffirmed the debtor's liability as to an unknown amount of charges at the termination of the lease.

Summary: Chapter 7 debtors entered into a lease reaffirmation agreement with a car dealer. The debtors signed the agreement, averring that the agreement did not impose an undue hardship and that debtors would be able to make payments under the agreement. According to the agreement, the debtors had a total monthly income of $5,204.16 and expenses of $6,147.53. Because the agreement created a negative monthly net income for the debtors, a presumption of undue hardship arose pursuant to 11 U.S.C. § 524(m)(1), which the Court was required to review.

The court noted that the lease purported to reaffirm not only the stream of payments due under the lease but also the debtors' continuing liability for all amounts due at the termination of the lease

The court held that debtors failed to rebut the presumption of undue hardship and disapproved the agreement.

***In re Jarrett*, Case No. 12-11453, 2014 WL 1393954 (Bankr. M.D.N.C. Apr. 9, 2014) (Kahn, J.)**

Issue: Whether a chapter 7 trustee could exempt a debtor's partial remainder interest in real property from abandonment under 11 U.S.C. § 554(c), when the debtor's eighty-year-old mother held a life estate in the property.

Short Answer: The court denied the trustee's request for an order excepting the debtor's real property interest from abandonment where the debtor's interest was co-owned, of minimal value, and subject to a life estate owned by an eighty-year-old woman in good health.

Summary: Chapter 7 debtors owned a one half remainder interest in real property subject to a life estate held by the male debtor's eighty-year-old mother who was in good health. The scheduled value of the male debtor's fractional interest was $7,110 subject to a $4,568.28 exemption. A bank held a lien on the property in the amount of $42,362.

The trustee filed a motion seeking an order excepting the property from abandonment upon the closing of the case pursuant to 11 U.S.C. § 554(c). Due to the existence of the life estate and the joint ownership of the remainder interest, the trustee determined there was no way to currently realize the value the interest in the property, and argued that abandonment of the asset would result in an unwarranted benefit to the male debtor and inappropriate harm to the creditors. The debtors argued that indefinitely excepting the asset from abandonment was inequitable in light of the minimal value of the asset, the fact that most of its value was exempt without objection, and the owner of the life estate was in good health.

The court cited *In re Hart*, 76 B.R. 774 (Bankr. C.D. Cal. 1987), which recognized three factors as relevant to deciding whether to except property from abandonment: "(1) there is reasonable possibility that an asset valuable enough to pay substantial dividends to the creditors may be recovered in the future; (2) the event triggering the reopening of the case is clearly defined and will not require further action by the trustee; and (3) the triggering event is not likely to occur so soon that the case should just remain open." With respect to the third factor, the court stated that it should also be likely that the triggering event will occur within a reasonable period of time. The court also proposed three additional factors: "(4) the existence of a co-owner in the property at issue and the equities with respect to the rights of the co-owner; (5) the possibility that it will be economically impractical to reopen the estate to administer the asset; and (6) if the estate is not reopened, whether the retention of the asset in the estate could result in a perpetually unmarketable asset."

Applying the factors in this case, the court denied the trustee's motion for an order excepting the debtor's interest from abandonment.

***Walter v. Freeway Foods Inc., et al. (In re Freeway Foods of Greensboro)*, Case No. 10-11282, Adv. Pro. No. 10-02057, 2014 WL 1652435 (Bankr. M.D.N.C. Apr. 24, 2014) (Aron, J.)**

Issue: Whether the attorney-client privilege applied to a defendant's communications to a non-attorney, when the defendants' officers reasonably believed that the person was a licensed attorney.

Short Answer: The attorney-client privilege protected the defendant's officers' communications with its general counsel even though the general counsel was not a licensed attorney because the defendant's officers reasonably believed they were dealing with a licensed attorney.

Summary: During discovery, the plaintiff requested copies of certain communications between the defendant's officers and its general counsel and sought to question him regarding these communications at a deposition. The defendant's general counsel performed legal services in Georgia, where defendant was incorporated, but the general counsel held only an inactive license to practice law in the State of Illinois. The general counsel also displayed his law school diploma and bar certificate outside his cubicle. The defendant's officers, who hired the general counsel, believed him to be an attorney and understood communications with him to be privileged. Outside counsel who performed legal work for the defendant also understood him to be both an attorney and the defendant's general counsel.

The plaintiff filed a motion to compel answers to the discovery requests as the general counsel was not in fact a licensed attorney. Under North Carolina law, for a communication between a client and his attorney to be privileged, "the attorney-client relation must have existed at the time of the communication." *State v. Campbell*, 629 S.E.2d 345, 350 (N.C. App. 2006). An attorney-client relationship exists when the client reasonably believes that he is dealing with an attorney, even if the client is mistaken. 1-5 Brandis and Broun on North Carolina Rules of Evidence § 129 (citing Uniform Rule of Evidence 502(a)(3); *State v. Wiley*, 565 S.E.2d 22 (N.C. 2002)).

The court held that the attorney-client privilege protected the communications at issue between the defendant and the general counsel even if the general counsel was not an attorney at the time they were made, because the defendant's officers reasonably believed they were dealing with an attorney.

***In re Truesdale*, Case No. 13-10941 (Bankr. M.D.N.C. May 6, 2014) (Kahn, J.)**

Issue: Whether a chapter 7 trustee could sell real property free and clear of tax liens under 11 U.S.C. §§ 363 and 724, when the proposed sale price was less than the aggregate amount of all liens on the property.

Short Answer: The chapter 7 trustee's motion to sell real property free and clear of tax liens under §§ 363 and 724 was granted where the tax lienholders could be compelled to accept a money satisfaction of their interests under § 724(b).

Summary: The chapter 7 trustee filed a motion to sell a debtor's real property free and clear of liens. The United States and the

State of North Carolina held tax liens on the property and had not affirmatively consented to the proposed sale, and the proposed sale price was not greater than the aggregate value of all liens on the property. Nonetheless, the trustee argued that the sale was authorized pursuant to § 363(f)(5), which provides that "a trustee may sell property . . . free and clear of any interest in such property of an entity other than the estate, only if . . . such entity could be compelled, in a legal or equitable proceeding, to accept money satisfaction of such interest." 11 U.S.C. § 363(f)(5).

In applying § 363(f)(5) to the facts at hand, the court first determined whether the tax liens at issue were "interests" within the meaning of § 363(f)(5). In *In re Canonigo*, 276 B.R. 257, 263 (Bankr. N.D. Cal. 2002), the court held that § 363(f)(5) does not apply to liens at all, and only applies to other types of interests in real property. In reaching this conclusion, the *Canonigo* court found that interpreting § 363(f)(5) to apply to liens would swallow up § 363(f)(3), which allows a trustee to sell property free and clear of any interest if "such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property." 11 U.S.C. § 363(f)(3). The *Conanigo* court found that interpreting § 363(f)(5) to apply to liens would allow that section to be used whenever the sale of property would not satisfy all liens, rendering § 363(f)(3) superfluous.

The court rejected the approach advocated by the *Conanigo* court, stating that it wrongly assumed § 363(f)(3) requires all liens to be *paid in full* by the sale of the property. Rather, § 363(f)(3) only requires that the *sale price* of the property exceed the aggregate value of the liens. In support of this interpretation, the court looked to § 724(b), which authorizes the subordination of certain tax liens to unsecured priority claims in the disbursement of the proceeds of a sale of real property. The court found that § 724(b) contemplated a disbursement scheme by which the proceeds of property subject to certain tax liens may be insufficient to pay all such liens in full even though the sale price might have exceeded the aggregate value of the liens. The court noted that if § 363(f)(3) required the sale price to be sufficient to *pay in full* the aggregate value of the liens and § 363(f)(5) did not apply to liens, then there would be no need for § 724(b) to subordinate tax liens to ensure payment of certain priority claims.

The court concluded its analysis by stating that § 724(b) is the type of legal or equitable proceeding contemplated by § 363(f)(5) under which a tax lienholder could be compelled to accept a money satisfaction of its lien. Accordingly, the court granted the trustee's motion.

***In re Paterno,* 511 B.R. 62 (Bankr. M.D.N.C. 2014) (James, J.)**

Issue: Whether a case could be dismissed for cause under 11 U.S.C. § 1112(b)(4)(A) when the creditor failed to establish any substantial or continuing post-petition loss to the estate.

Short Answer: No. A creditor's motion to convert the debtors' chapter 11 case to chapter 7 was denied where the creditor failed to put forward evidence establishing that the debtors sold assets or incurred additional debts after filing their bankruptcy petition.

Summary: A chapter 11 debtor was a shareholder in two concrete insulation companies. To finance the construction of a production facility in South Carolina, the companies sold over $10 million in bonds to a creditor. The bonds were personally guaranteed by the debtor and his wife, also a debtor. After two years of construction, the general contractor working on the facility committed suicide, and construction ceased. The creditor commenced two actions in state court relating to the bonds and obtained judgments against the debtors in the amounts of $7,092,225.13 and $3,381,550.76 plus interest. The debtors filed for bankruptcy protection.

The creditor sought to convert debtors' chapter 11 bankruptcy case to chapter 7 for cause pursuant to 11 U.S.C. § 1112(b)(4)(A). Under § 1112(b)(4)(A), cause exists to dismiss or convert a case if the movant establishes (1) "substantial or continuing loss to or diminution of the estate" post-petition, and (2) the "absence of a reasonable likelihood of rehabilitation."

The first prong of the test may be met by showing that the debtor suffered a negative cash flow or declining asset values following the entry of the order for relief. Creditor argued that debtors failed to obtain employment for the previous two years, liquidated approximately $433,000 of stock, survived solely on credit card debt, and failed to pay their taxes. The record showed, however, that since the debtors filed their bankruptcy petition, they had not sold any assets or incurred any credit card debt. The court therefore, held that the creditor failed to show any substantial or continuing post-petition loss to the estate. The court did not need to reach the second prong of the test because the creditor had failed to satisfy the first prong.

***In re Smith*, Case No. 13-81362 (Bankr. M.D.N.C. June 3, 2014) (Kahn, J.)**

Issue: Whether a debtor's ex-spouse could file a claim for mortgage payments that the debtor was required to make under a prior court order when the claimant had not actually made any payments himself on the debt to be reimbursed.

Short Answer: A claim by the debtor's former spouse alleging that the debtor was required to make certain mortgage payments was disallowed because the claimant had not made any payments towards the debt for which he sought repayment.

Summary: A chapter 13 debtor and a claimant in the debtor's bankruptcy case were divorced. During their marriage they owned two properties as tenants by the entireties, a home and a farm. The claimant filed a general unsecured claim in the debtor's bankruptcy case in the amount of $570,380. The claimant argued that, pursuant to the court orders arising out of the parties' divorce, the debtor was required to make all payments on the parties' home equity loan and farm equity loan, among other debts. The claimant himself had yet to make any payments on these debts.

The Bankruptcy Code allows co-debtors to file claims against the estate by way of reimbursement, contribution, or subrogation. Specifically, 11 U.S.C. § 502(a) provides that "an entity that is liable with the debtor…on the claim of a creditor" may file a claim on its own behalf for reimbursement or contribution. The claim will be allowed to the extent that the creditor's claim is allowed, but disallowed so long as its status remains contingent. *Id.*

Section 509 provides that a co-debtor who pays a claim filed against the debtor may assert a claim by way of subrogation, thereby stepping into the creditor's shoes. 11 U.S.C. § 509(a). Some courts have also held that a co-debtor may in some circumstances file a subrogation claim under state common law. However, in either case, the party seeking subrogation must make some payment towards the debt in order to maintain a claim for subrogation; the doctrine is available only "when one person has been compelled to pay a debt which ought to have been paid by another." *Trustees of Garden of Prayer Baptist Church v. Geraldco Builders, Inc.*, 78 N.C. App. 108, 114, 336 S.E.2d 694, 697-98 (1985).

The court found that the claimant's claim was contingent because he had "not made any payment towards the debt for which he might be entitled to repayment." Therefore, the court disallowed the claim.

In re O'Neal, **Case No. 14-10603 C-13G (Bankr. M.D.N.C. June 19, 2014) (James, J.)**

Issue: Whether the automatic stay should be imposed when the debtor had filed three bankruptcy petitions in a one-year period and there was no material change in her financial circumstances.

Short Answer: The debtor's motion for imposition of the automatic stay was denied where the debtor had filed three bankruptcy petitions in a one-year period and failed to demonstrate a material increase in income or a decrease in expenses demonstrating that her petition was filed in good faith.

Summary: A chapter 13 debtor filed a motion to impose an automatic stay pursuant to 11 U.S.C. § 362(c)(4) in the debtor's fifth chapter 13 bankruptcy filing since October 2009 and third filing within the previous year.

Section 362(c)(4)(A) of the Bankruptcy Code provides that if a debtor files a bankruptcy case and two or more cases of the debtor were pending within the previous year, the automatic stay will not go into effect upon the later filing. Section 362(c)(4)(B) provides that the Court may order the stay to take effect if a party in interest demonstrates that the filing of the latter case is in good faith. Section 362(c)(4)(D)(i) establishes a presumption that the case was not filed in good faith if, *inter alia*, the debtor has not provided clear and convincing evidence of a substantial change in financial or personal affairs since dismissal of the next most previous case or any other reason such that a confirmed chapter 13 plan can be fully performed.

The debtor argued that health improvements from a kidney transplant, her daughter's graduation from high school, and the termination of payment for her mother's funeral expenses would allow her to make regular plan payments in the future.

The court held that the debtor had not demonstrated any material increase in income or decrease in expenses with her schedules filed in the case, which actually showed a decrease in income. Therefore, the debtor's motion was denied.

In re Hamilton, **Case No. 13-51213, 2014 WL 2986705 (Bankr. M.D.N.C. July 2, 2014) (Aron, J.)**

Issue: Whether mortgage payments can be included in a debtor's chapter 7 means test calculation when the debtor intends to surrender the property.

Short Answer: It was improper for the debtor to deduct the mortgage payments.

Summary: The bankruptcy administrator filed a motion to dismiss or convert chapter 7 debtor's bankruptcy case as an abuse of the provisions of chapter 7. The debtor had included in her chapter 7 petition a statement of current monthly income ("CMI") and a means test calculation, which the court would use to determine whether the filing was presumptively abusive. 11 U.S.C. § 717(b)(2). The debtor purported to deduct monthly mortgage payments from her CMI calculation pursuant to § 707(b)(2)(A)(iii), which authorizes deductions for "the debtor's average monthly payments on account of secured debts" including "amounts scheduled as contractually due to secured creditors."

The bankruptcy administrator argued that these amounts could not be deducted from the debtor's CMI because the mortgage payments related to property the debtor intended to surrender. The debtor argued that because the payments remained "contractually due," it did not matter whether or not she intended to surrender the property.

The court relied upon *Ransom v. FIA Card Services, N.A.,* 131 S.Ct. 716 (2011), in which the United States Supreme Court interpreted the use of the term "debtor's" in § 707(b)(2)(A)(ii)(I) to require "an individualized determination by referring to *the debtor's* applicable monthly expense amount." The *Ransom* court also held that "requiring a debtor to incur the kind of expenses for which he claims a means-test deduction . . . advances the [Bankruptcy Abuse Prevention and Consumer Protection Act's] objectives." *Ransom,* 131 S.Ct. at 721.

Applying the Supreme Court's holding in *Ransom*, the court held that under § 707(b)(2)(A)(iii), the debtor could not deduct secured debt payments on collateral the debtor did not intend to retain. The evidence showed that the debtor did not intend to retain her home: the debtor twice indicated at a meeting of the creditors that she did not intend to keep the property; she did not exempt the property; she offered no opposition to a secured creditor's motion for relief from stay as to the property; and she failed to satisfy her obligation to assert intent either to retain or surrender the property. After recalculating the debtor's CMI, the court determined that the debtor's filing was presumptively abusive and, because there were no special circumstances rebutting the presumption, granted the bankruptcy administrator's motion for dismissal or conversion to chapter 13.

In re Currin**, Case No. 13-51419 (Bankr. M.D.N.C. July 15, 20114) (James, J.)**

Issue: Whether an unsecured claim based upon an unrecorded confession of judgment should be disallowed.

Short Answer: The debtor's objection to the creditor's proof of claim was overruled where the debtor breached a settlement agreement that incorporated the terms of an unrecorded confession of judgment.

Summary: A chapter 13 debtor and a creditor resolved a construction contract lawsuit by executing a confession of judgment and a settlement agreement. In the confession of judgment, the debtor acknowledges a debt of $20,000 plus interest. The settlement agreement provided that the debtor would make monthly payments to the creditors totaling $4,500 and that the creditor would not record the confession of judgment so long as the payments were made. The debtor defaulted on the settlement agreement and filed a petition under chapter 13. The creditor filed a proof of claim asserting an unsecured claim for breach of the settlement agreement seeking the unpaid portion of the debt. The debtor argued that because the confession of judgment was not recorded prior to the petition date, it had no effect.

The court held that, although the creditor was not entitled to enforce the confession as a judgment pursuant to N.C. Gen. Stat. § 1-A, Rule 68.1, the creditor could still file a general unsecured claim, "thereby triggering the bankruptcy claims allowance process to determine the amount of the debtor's liability for the prepetition breach of the Settlement Agreement."

The settlement incorporated the terms of the confession of judgment, which acknowledged the debtor's indebtedness to the creditor. Therefore, the court overruled the debtor's objection to the creditor's claim.

***In re Bolden*, Case No. 13-11254C-7G, 2014 WL 690514 (Bankr. M.D.N.C. Feb. 21, 2014) (Kahn, J.)**

Issue: Whether service of a motion was sufficient when it was sent to a corporation's general mailing address and not to the attention of an individual officer authorized to receive service.

Short Answer: Service of a motion to avoid a judicial lien on a corporation was insufficient where the debtor sent a copy of the motion to the corporation's general mailing address and not to the attention of an individual officer authorized to receive service for the corporation. Sending the motion to the corporation's attorneys was also insufficient where the corporation had not participated in the bankruptcy case.

Summary: A chapter 7 debtor moved to avoid a judicial lien in favor of a corporation. The debtor attempted to serve the motion by mailing a copy to the corporation's mailing address and by mailing a copy to the corporation's attorneys. The judgment creditor did not file a proof of claim, notice of appearance, or anything else designating an agent to receive service of process.

Bankruptcy Rule 7004(b)(3) provides that service on a corporation may be made by mailing the motion "to the attention of an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the defendant". For service upon counsel to be effective, counsel must have authority as an agent to accept service of process.

"A corporation can expressly or implicitly appoint an entity (including, without limitation, counsel) to serve as an agent to receive service of process." [*In re Reisman*, 139 B.R. 797, 801 (Bankr. S.D.N.Y. 1992).] "When a defendant takes an active role in a . . . [bankruptcy] case and appears through counsel in a proceeding integrally related to the case, such counsel is implicitly authorized to receive process for the defendants." *Id.*

The court held that because service of the motion was not addressed to the attention of any particular individual or officer with the corporation, and because the creditor had not taken any action through counsel in the bankruptcy case that would create implied authority to accept service of process, service was insufficient.

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