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Bankruptcy Survey

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Bankruptcy Survey

I. Introduction

In spite of the recession (perhaps because of it), the caseload of the Tenth Circuit was not demonstrably heavier than in prior years. As will be seen, a number of the cases involved interesting examples of judicial interpretation and application of various provisions of the 1978 Bankruptcy Code as amended. A number of them will be, or have been appealed to the Supreme Court. If there is any theme or trend in the Circuit, it is continuing interpretation of that still relatively new statute.

This survey attempts to describe and analyze selected cases of the Tenth Circuit for the 1991 calendar year. The only bankruptcy cases ignored for this purpose have been unreported cases, cases involving only matters of procedure and cases involving only questions of state law unrelated to bankruptcy issues. The cases selected for treatment cover a broad range of topics and many should be of interest to non-specialists.

II. Powers of the Bankruptcy Court

In 1991, the Tenth Circuit encountered an array of diverse questions on the powers of the bankruptcy court. None of the cases involved jurisdictional questions; a few involved routine matters and have been omitted from this survey.

A. *Application of Equal Access to Justice Act:* O'Connor v. U.S. Dept. of Energy

In the first case, *O'Connor v. U.S. Department of Energy*,[1] the Tenth Circuit held that a bankruptcy court was a "court" within the meaning of a provision of the Equal Access to Justice Act ("EAJA"). The EAJA provides that "a court shall award to a prevailing party . . . fees and . . . costs . . ." in certain cases "brought by or against the United States in any court having jurisdiction of that action . . . ."[2] The Department of Energy ("DOE"), as an unsecured creditor in a bankruptcy proceeding, had filed a motion to enforce a reorganization plan and alternatively, to convert the bankruptcy from a Chapter 11 to a Chapter 7 proceeding. After the bankruptcy court denied the motion, the debtor requested and the court granted costs and attorney fees under the above cited provision of EAJA. Upon appeal, the district court reversed; debtor appealed to the Tenth Circuit.

The only circuit to have addressed the application of 28 U.S.C. § 2412(d)(1)(a) to bankruptcy courts was the Eleventh Circuit. How-

1. 942 F.2d 771 (10th Cir. 1991).
2. 28 U.S.C. § 2412(d)(1)(A).

ever, the Eleventh Circuit's decision, *In re Davis*,[3] was controlled by *Bowen v. Commissioner of Internal Revenue*[4] which held that the non-Article III tax court lacked jurisdiction to award EAJA fees. In *O'Connor*, the Tenth Circuit declined to let the issue turn on whether a court was an Article III court. Applying a "plain meaning of the language" approach, the court noted the differing terms "court" and "Court of the United States" and concluded that the term "a court" and "any court" included the bankruptcy court.[5] A final comment noted that this result was consistent with the "undisputed purpose of the EAJA to encourage individuals and small businesses to challenge adverse government action notwithstanding the high cost of civil litigation."[6]

B. *Right to Jury Trial:* In re Republic Trust & Savings Co.

In re Republic Trust & Savings Co.[7] is one chapter of a case originally decided by the Tenth Circuit in 1990[8] and reviewed by the Supreme Court in the same year.[9] Inasmuch as last year's Denver University Law Review Tenth Circuit Survey did not include bankruptcy cases, mention of the case in this year's survey seems appropriate.

Republic Trust & Savings was an uninsured financial institution which filed a Chapter 11 petition in 1984. A year later, the trustee (Langenkamp or the predecessor trustee), instituted adversary proceedings to recover voidable preferences against appellants who had redeemed thrift and passbook savings certificates totaling over $713,919 within the 547(b) ninety day look back period (preceding the filing of the petition).[10]

After a bench trial, the bankruptcy court found that the payments constituted voidable preferences and the appellants appealed. In the 1990 decision, the Tenth Circuit panel held that the payments were not excepted under either 11 U.S.C. § 547(c)(1) or (c)(2)[11] and these conclusions were not appealed. An additional argument of the appellants in

3. 899 F.2d 1136 (11th Cir. 1990) *cert. denied*, 111 S. Ct. 510 (1990). *See also* In re Brickell Inv. Corp., 922 F.2d 696 (11th Cir. 1991).

4. 706 F.2d 1087 (11th Cir. 1983).

5. 942 F.2d at 773-74.

6. *Id.* at 774.

7. 924 F.2d 997 (10th Cir. 1991).

8. In re Republic Trust & Savings Co. (Langenkamp v. Hackler), 897 F.2d 1041 (10th Cir. 1990), *cert. denied*, 111 S.Ct. 245 (1990).

9. Langenkamp v. Culp, 111 S. Ct. 330 (1990).

10. 11 U.S.C. § 547(b)(4)(A) reads in pertinent part: (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—. . . (4) made—(A) on or within 90 days before the date of filing of the petition . . . .

11. 11 U.S.C. § 547(c)(1) and (2) state:

(c) The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was—

the 1990 Tenth Circuit case, was that the district court had erred in denying them a jury trial on the trustee's preference claims.

The Tenth Circuit, applying the complex test of the recent Supreme Court decision, *Granfinanciera, S.A. v. Nordberg*,[12] agreed that those appellants who had not filed claims against the debtor's estate were clearly entitled to a jury trial. Surprisingly, in an attempt to apply the law of the *Granfinanciera* case, the Tenth Circuit held that even those appellants who *did* file claims were also entitled to a jury trial.[13] Apparently, the court felt the trustee's action against *all* recipients of payments should be subject to the right to a jury trial, even though some of the recipients filed claims, because certain of the claimants still had monies invested with the bankrupt.

The trustee filed a petition for writ of certiorari to the Supreme Court on this last point and in a brief per curiam opinion, the Court stated:

> In *Granfinanciera* we recognized that by filing a claim against the bankruptcy estate the creditor triggers the process of "allowance and disallowance of claims," thereby subjecting himself to the bankruptcy court's equitable power . . . . If the creditor is met, in turn, with a preference action from the trustee, that action becomes part of the claims-allowance process which is triable only in equity.[14]

On remand, the Tenth Circuit vacated that portion of its prior opinion granting a right of jury trial to those appellants which had filed claims against the estate.

C. *Control of Dilatory Debtors:* In re Frieouf

In a case involving administration of estate issues, debtor Randy Arden Frieouf filed an underlying Chapter 11 petition on September 20, 1985.[15] Frieouf engaged in conduct for over three years (throughout the bankruptcy proceedings), which evidenced a pattern of evasion. For example, debtor failed to file a plan within the time limits, failed to comply with orders to file disclosure statements, and was dilatory in filing an amended disclosure statement and a third reorganization plan over a period of three years. On February 14, 1989 the bankruptcy court dismissed the Chapter 11 petition with prejudice to the filing of any bankruptcy petition for three years. The district court affirmed. Frieouf

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> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
> (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
> (C) made according to ordinary business terms
> . . . .

12. 492 U.S. 33 (1989).

13. "Despite these appellants' claims, the trustee's actions to avoid the transfers, consolidated by the bankruptcy court, were plenary rather than a part of the bankruptcy court's summary proceedings involving the 'process of allowance and disallowance of claims.'" 897 F.2d at 1046-47.

14. *Langenkamp*, 111 S. Ct. at 331.

15. *In re Frieouf*, 938 F.2d 1099 (10th Cir. 1991), *cert. denied*, 117 L.Ed.2d 408 (1992).

appealed to the Tenth Circuit, claiming, inter alia, that the bankruptcy court had no authority to limit access to bankruptcy relief for three years.

Section 349(a)[16] of the Bankruptcy Code authorizes a bankruptcy court to permanently disqualify a class of debts from discharge for cause. But the section does not on its face state that a bankruptcy court may deny future access to bankruptcy.[17] The Tenth Circuit (Judge Seth) reasoned that the statute's language was plain and held that the bankruptcy court's denial of all access to bankruptcy court for more than 180 days was beyond the authority conferred by section 349(a).[18] The Tenth Circuit upheld the order dismissing Frieouf's bankruptcy, but reversed and remanded the district court's affirmance of the bankruptcy court's judgment denying the debtor all access to court beyond 180 days for debts unrelated to this case.[19]

D. *Bankruptcy Court Supervision — Formal Notice to Creditors in Chapter 11 Cases:* In re Unioil

A relatively routine case, *In re Unioil*,[20] involved the bankruptcy court's powers of supervision over the administration of a case. The debtor was an oil and gas exploration company which filed for reorganization under Chapter 11. In spite of the filing, one of its officers made post-petition transfers, triggering creditor objections that led to a stipulation and court order that Unioil would make no transfers without court approval. After confirmation of the plan, the creditors' committee discovered transfers and assignments to parties related to the debtor in violation of this order. The bankruptcy court granted a motion to set aside such transfers and issued an order to that effect. After a hearing, the court also entered an order barring the claims of the assignees inasmuch as the court found such assignees (limited partnerships related to the debtor) were on inquiry notice of the bankruptcy proceedings.[21]

Initially, the Tenth Circuit faced a jurisdictional question. The notice of appeal had identified appellants as "Appellant Partnerships, Dal-

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16. 11 U.S.C. § 349(a) reads:

(a) Unless the court, for cause, orders otherwise, the dismissal of a case under this title does not bar the discharge, in a later case under this title, of debts that were dischargeable in the case dismissed; nor does the dismissal of a case under this title prejudice the debtor with regard to the filing of a subsequent petition under this title, except as provided in section 109(f) of this title.

17. *See also*, 11 U.S.C. § 109(g):

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if—

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

18. 938 F.2d at 1104.

19. *Id.* at 1105.

20. 948 F.2d 678 (10th Cir. 1991).

21. *Id.* at 680-81.

ton Development Project No. 1 *et al.* and other partnerships."[22] Van Bebber, district judge sitting by designation, applied *Torres v. Oakland Scavenger Co.*[23] which held that "*et al.*" fails to provide notice to the appellants. Thus, the Tenth Circuit had appellate jurisdiction only over Dalton.[24]

The opinion had little problem with the creditor's argument that the order setting aside the transfers was invalid. The court held that such an order was a valid exercise of the court's equitable power to enforce its own orders.[25] The Tenth Circuit did, however, reverse that part of the bankruptcy court's order barring the claims of Dalton Development.[26] Debtor relied on *In re Green*,[27] in arguing that actual knowledge of the bankruptcy proceeding amounted to constitutionally adequate notice. However, *Unioil* distinguished the notice required in a Chapter 7 case such as *Green*, from the actual formal notice required by *Reliable Electric Co., Inc. v. Olson Construction Co.*,[28] for the purposes of a Chapter 11 proceeding.[29] In light of the above conclusion, the court reversed the lower court decision and remanded for appropriate action.

III. Automatic Stay

A necessary feature of any bankruptcy proceeding is the automatic stay which prevents most creditor activity with respect to the assets of the estate. Recurring reports in the press to "filings under the protection of bankruptcy" reflect this feature of the law. Two cases from the Tenth Circuit 1991 caseload interpreted this important provision.

A. *Tolling Effect of the Automatic Stay:* Valley Transit Mix of Ruidoso, Inc. v. Miller

In order that bankruptcy does not cause the loss of a non-bankruptcy right, 11 U.S.C. § 108(c)[30] provides for the tolling of any non-

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22. *Id.* at 681.
23. 487 U.S. 312 (1988).
24. 948 F.2d at 681-82.
25. *Id.* at 682.
26. Apparently, the barring of the claims of the other unnamed partnerships are not affected by this decision in that as ruled, *supra*, they were not within the jurisdiction of this appeal.
27. 876 F.2d 854 (10th Cir. 1989).
28. 726 F.2d 620 (10th Cir. 1984).
29. *See also* N.Y. v. New York, N.H. & H. R.R. Co., 344 U.S. 293 (1953) indicating that a creditor with actual knowledge of a reorganization proceeding has no duty to inquire about further court action.
30. 11 U.S.C. § 108(c):

> (c) Except as provided in section 524 of this title, if applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor, or against an individual with respect to which such individual is protected under section 1201 or 1301 of this title, and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of—
>
> (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
>
> (2) 30 days after notice of the termination or expiration of the stay

bankruptcy statute of limitations during the period the stay is in effect. *Valley Transit Mix of Ruidoso, Inc. v. Miller*[31] involved an action by B.C.R. and others to enforce mechanic's liens against land owned by the Miller group. The land had been leased to Ruidoso Recreation, Inc. which made the improvements on the Miller land. Shortly after B.C.R. filed its lien, Ruidoso filed bankruptcy. The issue was the effect of the automatic stay arising out of that bankruptcy on the enforcement of the lien against the Miller land. Miller argued that the instant action to enforce the B.C.R. lien was time-barred by the New Mexico statute inasmuch as B.C.R.'s action to enforce the lien against Miller's land was not stayed by the Ruidoso bankruptcy. The lower courts rejected this narrow reading of the scope of the automatic stay. The Tenth Circuit affirmed, holding that the automatic stay applied to action to enforce a debt against the debtor-lessee, including the foreclosure of a lien against land of the lessor.[32] Thus, B.C.R. was protected by the tolling of the New Mexico statute by the bankruptcy filing pursuant to section 108(c).

B. *Exception for Governmental Proceedings:* Eddleman v. United States Dept. of Labor

The 1978 Bankruptcy Code specifically provides that the filing of a petition does not operate to stay "the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power."[33] In *Eddleman v. United States Dept. of Labor*,[34] the debtors operated a mail-hauling business which they continued to operate as debtors-in-possession after a Chapter 11 filing. After such filing, the Department of Labor (DOL) filed an administrative action against the debtors alleging pre-petition violations of the Service Contract Act[35] (SCA) requiring minimum wages and benefits for those obtaining certain federal contracts. As part of this action, DOL sought to liquidate claims for back wages due the debtors' employees and to include the Eddlemans on a list of entities debarred from contracting with the government for a three year period. The bankruptcy court held that the action was subject to the automatic stay and did not come within the section 362(b)(4) exception.[36] The district court affirmed noting that the exception was intended to prevent viola-

under section 362, 922, 1201, or 1301 of this title, as the case may be, with respect to such claim.

31. 928 F.2d 354 (10th Cir. 1991).

32. *Id.* at 355-56.

33. 11 U.S.C. § 362(b)(4):

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), does not operate as a stay—

. . .

(4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power

. . . .

34. 923 F.2d 782 (10th Cir. 1991).

35. 41 U.S.C. §§ 351-58 (1988).

36. 923 F.2d at 790.

tions of regulatory laws. It also reasoned that "regulatory laws that conflict directly with control of the *res* or property by the bankruptcy court are not excepted by Section 362(b)(4)."[37] The Eddlemans appealed to the Tenth Circuit which reversed.

Much of the Tenth Circuit opinion, authored by Judge McKay, involved a jurisdictional question of appealability. Holding that a denial of the DOL's claim of exemption from the automatic stay was an appealable final order, the court turned to the issue involving the asserted exemption. The court outlined two tests which have been used by the bankruptcy courts to determine the scope of the governmental exemption.[38] Under the "pecuniary purpose" test, the exemption does not apply if the governmental action is primarily for the purpose of protecting a pecuniary interest as opposed to protecting matters of public policy. The "public policy" test asks whether the action is aimed at effectuating public policy or if it is aimed at adjudicating private rights. Actions taken for the purpose of advancing private rights are not included within the exemption.

The instant case does not admit of an easy answer. Certain minimum wages and benefits are required by the SCA. The administrative activity would determine how much the bankrupts owe their employees, and in that regard the proceedings do adjudicate private rights. On the other hand, the proceedings might result in an order taking the bankrupts off the list of approved contractors who deal with the United States. Unfortunately, the Tenth Circuit decision leaves many questions unanswered. It reversed the lower courts without adopting either of the above outlined tests. The court preliminarily rejected the district court's limitation of the exemption because it interfered with the bankruptcy court's control over debtor assets.

The Tenth Circuit opinion pointed out that the language of section 362(b)(4) contained no such limitation.[39] Next, the court ruled that the DOL's proceedings were exempt from the automatic stay under either the "pecuniary purpose" test or the "public policy" test.[40] As to the "pecuniary purpose" test, the opinion concluded that the agency's action with respect to wages had the purpose of preventing unfair competition.[41] With respect to the "public policy" test, the agency request for determination of back-pay claims implemented the policies of the SCA.[42]

37. *Id.*
38. These tests are outlined in a Sixth Circuit case, NLRB v. Edward Cooper Painting, 804 F.2d 934, 942 (6th Cir. 1986).
39. 923 F.2d at 790.
40. *Id.* at 791. There is not much difference between these tests although they are apparently treated as two separate tests. Perhaps the courts should combine the tests and refined the single resulting test. There is not that much authority on the issue at this time. *See id.* at 790, n.12.
41. *Id.* at 791.
42. *Id.*

IV. PROPERTY OF THE ESTATE

Under 11 U.S.C. § 541, the bankruptcy estate is created from all of the non-exempt property of the debtor as of the commencement of the case. With certain limited exceptions, assets acquired by the debtor after the commencement of the case[43] belong to the debtor and are part of the debtor's "fresh start." One Tenth Circuit case in 1991 involved a significant issue regarding pensions, which issue is currently being reviewed by the Supreme Court.

A. *Pension and Profit Sharing Plan:* In re Harline

An interesting and important case for attorneys generally and bankruptcy attorneys particularly is *In re Harline*,[44] in which the Tenth Circuit held that a pension and profit sharing plan, one which was a qualified plan under the Employee Retirement Income Security Act ("ERISA"),[45] was not part of the bankruptcy estate. There is now a significant split on this question involving at least eight circuits. The Supreme Court has recently granted review in one of these cases.[46]

The debtor, a Dr. Harline, filed a petition for reorganization of his affairs under Chapter 11 and the petition was subsequently converted into Chapter 7 proceedings. The debtor had not listed as an asset of his estate his beneficial interest in a profit sharing trust of the Weber Clinic, Inc. The trust had been established as a corporate retirement plan in 1960. At the time of the bankruptcy filings, Weber Clinic was a professional corporation with the bankrupt as the sole shareholder. He was also the sole remaining beneficiary of the trust and sole member of its deferred compensation committee. The assets of the trust were three insurance policies with cash values totaling over $300,000.

After learning of the existence of this asset, Gladwell, the bankruptcy trustee, sued the bank trustee of the plan. Harline assumed responsibility for the defense of the action and alleged that his interest in the plan was not an asset of the estate under 11 U.S.C. § 541(c)(2) which provides: "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law is enforceable in a case under this title." Specifically, Harline made the argument that the trust was within this subsection either (1) because the trust was a valid spendthrift trust under Utah law, or (2) because the trust qualified as a pension and profit sharing plan under ERISA. The bankruptcy court ordered the plan to turn over the asset, the district court affirmed and Harline appealed.

The first part of the opinion written by Judge Logan discussed the viability of Harline's argument that the plan was an effective spendthrift trust. It is generally conceded that "nonbankruptcy law" referred to in

43. The principle does not apply in Chapter 13 proceedings. 11 U.S.C. § 1306 (1988).
44. 950 F.2d 669 (10th Cir. 1991).
45. 29 U.S.C. §§ 1001-1461 (1988) (amended 1991).
46. Patterson v. Shumate, 112 S.Ct. 932 (1992).

section 541(c)(2)[47] applies at least to state law recognition of spendthrift thrusts. After an appropriate analysis of Utah law, the Tenth Circuit concluded that (1) Utah would probably recognize the doctrine of spendthrift trusts, but (2) the trust in question did not qualify as a spendthrift trust because of the bankrupt's control of the *res* as the only officer, director, and shareholder of the Weber Clinic which had the power to amend or terminate the plan.[48]

The second part of the *Harline* opinion wrestled with a question which has split the circuits:[49] Does an ERISA qualified pension come within the § 541(c)(2) provision as effective under "nonbankruptcy law?" A number of statutory provisions are relevant. Under ERISA, "each pension plan shall provide that benefits provided by the plan may not be assigned or alienated."[50] This provision suggests that a qualifying plan is a restriction on alienation effective under nonbankruptcy law and therefore is not property of the estate. On the other hand, the Code elsewhere exempts pension payments.[51] This provision suggests that to completely exempt a plan under ERISA would render its purpose meaningless. Judge Logan's opinion cites four circuits as limiting "nonbankruptcy law" to state spendthrift trust law.[52] The discussion in the legislative history does focus exclusively on state spendthrift trust law, supporting this view.

The opinion in *Harline* cited three recent circuit court holdings to the contrary.[53] Judge Logan characterized these cases as "hold[ing] that an appeal to legislative history is inappropriate here because the language of 541(c)(2) is clear."[54] The Tenth Circuit decision found no reason to narrowly read the language of the proviso. It determined that the legislative history was not limiting and cited other examples of federal law being included as "nonbankruptcy law."[55] Similarly, the opinion discussed the purposes of ERISA and concluded, "[o]ur construction of 541(c)(2) harmonizes the Bankruptcy Code with the clear policy and intent of ERISA."[56] The case was remanded for a determination as to whether the plan in question did in fact qualify under ERISA.

The issue in the *Harline* case is of obvious importance. The pres-

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47. *See supra* note 11.
48. 950 F.2d at 671-72.
49. *Id.* at 670.
50. 29 U.S.C. § 1056(d)(1) (1988).
51. *See* 11 U.S.C. § 522 (d)(10)(E) (1988), which exempts payments under a pension or profit sharing plan "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."
52. 950 F.2d at 673. (citing Daniel v. Security Pac. Nat'l Bank (In re Daniel) 771 F.2d 1352 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986); Lichstrahl v. Bankers Trust (In re Lichstrahl), 750 F.2d 1488, 1490 (11th Cir. 1985); Samore v. Graham (In re Graham), 726 F.2d 1268, 1273 (8th Cir. 1984); Goff v. Taylor (In re Goff) 706 F.2d 574, 577 (5th Cir. 1983)).
53. *Id.* (citing Forbes v. Lucas (In re Lucas), 924 F.2d 597, 601 (6th Cir.), *cert. denied*, 111 S. Ct. 2275 (1991); Velis v. Kardanis, 949 F.2d 78, 83 (3rd Cir. 1991); Anderson v. Raine (In re Moore), 907 F.2d 1476, 1477 (4th Cir. 1990)).
54. 950 F.2d at 673 (quoting In re Moore, 907 F.2d 1476, 1478 (4th Cir. 1990)).
55. *Id.* at 675.
56. *Id.*

ence of ERISA assets in future bankruptcies can only be expected to increase and the debtor's interest in a pension fund can constitute an attractive asset to the trustee in a no-asset case, or to creditors generally. Colorado lawyers should be aware of a recent amendment to the exemptions law of Colorado which adds to its list of exemptions:

> [p]roperty, including funds, held in or payable from any pension or retirement plan or deferred compensation plan, including those in which the debtor has received benefits or payments, or has the right to receive benefits or payments, or has the right to receive benefits or payments in the future and including pensions or plans which qualify under the federal "Employee Retirement Income Security Act of 1974" as an employee benefit plan, as defined in 29 U.S.C. § 1002, any individual retirement account, as defined in 26 U.S.C. § 408, and any plan, as defined in 26 U.S.C. § 401, and as these plans may be amended from time to time.[57]

This, of course, is of broader application than the decision in *Harline*, and of interest to planning attorneys.[58]

The Supreme Court has recently granted review of this question.[59] The case on review, *Shumate v. Patterson*,[60] is the second case from the Fourth Circuit to hold that the ERISA provision is "nonbankruptcy law" for the purposes of 11 U.S.C. § 541(c)(2).[61] *Patterson*, like the *Harline* case, involved a debtor who allegedly had great control of the funds remaining in the fund. A panel of the Fourth Circuit, in an opinion written by former Dean Phillips, held that all that was required for the section 541 proviso to apply was that the plan be ERISA qualified.[62] An additional chapter in this story should be in next year's survey.[63]

B. *Tax Refunds:* In re Barowsky

Tax refunds can be an important factor in planning the timing of the filing of a petition in bankruptcy. While *In re Barowsky*[64] includes no new law, it is included as another example of this recurring matter. The Barowskys filed a bankruptcy petition on July 24, 1987 and received a

57. Colo. Rev. Stat. § 13-54-102(1)(s), 1991 Cum. Supp. (effective May 1, 1991).

58. For a recent discussion of the possibilities of the Act and certain limitations, *see* Paul G. Hyman, Jr., *Prebankruptcy Planning: Conversion of Nonexempt Assets into Exempt Assets*, 21 COLO. LAW. 231 (1992).

59. Patterson v. Shumate, 112 S.Ct. 932 (1992).

60. Schumate v. Patterson, 943 F.2d 362 (4th Cir. 1991).

61. *See supra* note 11.

62. 943 F.2d at 365.

63. A recent decision in Pitrat v. Garlikov, 947 F.2d 419 (9th Cir. 1991) held that an Arizona statute similar to the above-cited Colorado statute is preempted by ERISA, 29 U.S.C. § 1144(a) which states:

> (a) Supersedure; effective date
>
> Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. This section shall take effect on January 1, 1975.

29 U.S.C. § 1144(a) (1988).

64. In re Barowsky, 946 F.2d 1516 (10th Cir. 1991).

discharge on December 3, 1987, upon the trustee's stipulation that it was a no-asset case. The trustee learned that the debtors received an income tax refund check for $1,092.74 for the 1987 calendar year. The trustee reopened the case to recover that part of the refund applicable to pre-petition earnings arguing that this asset was a pre-petition asset and thus was property of the estate. The Barowskys' motion to establish their right to the entire refund was denied by the bankruptcy court and the district court agreed.

The Tenth Circuit affirmed on the authority of *Kokoszka v. Belford*.[65] The debtor's attempt to distinguish the *Kokoszka* case (because the petition in bankruptcy in that case was filed after the end of the tax year) was rejected, as well as the argument that a change in the law was effected by the enactment of the Bankruptcy Act of 1978.

V. Debtor's Exempt Property

Only one Tenth Circuit case in 1991 dealt explicitly with the subject of debtor exemptions. The *Harline* case, discussed above, involved a related topic and should be consulted by the attorney who is counseling a debtor approaching the possibility of a bankruptcy filing. The case featured here concerned, among other issues, the question of what pre-bankruptcy financial activity is permissible in taking advantage of a statutory homestead exemption.

A. *Pre-bankruptcy Planning: Converting Nonexempt Property to Exempt in Anticipation of Bankruptcy:* In re Carey

Patricia G. Carey was a stockbroker and former officer and director of her husband's business, the Carey Lumber Company. In 1984, she executed a number of personal guarantees to cover the business's indebtedness.[66] Late in 1985 Carey Lumber began to experience cash flow shortages. The company filed a Chapter 11 petition on October 20, 1986 and Marine Midland, appellant, began an action for alleged fraud against Carey's husband. Carey filed her petition on April 20, 1988. Marine Midland filed an "Objection to Claim of Exemption" and a "Complaint Objecting to Debtor's Discharge" alleging that her activities in liquidating her nonexempt assets in order to reduce the mortgage on her homestead should lead to a court denial of the homestead exemption and that she should be denied a discharge.[67] Marine Midland also recited a number of acts as evidence of fraudulent intent. The bankruptcy court gave judgment in favor of Carey and she ended up with a homestead exemption under Oklahoma law on a $300,000 home with a $30,000 mortgage. The district court affirmed and Marine Midland appealed.

The Tenth Circuit affirmed the lower court rulings. The opinion

65. *Id.* at 1519 (citing *Kokoszka*, 417 U.S. 642 (1974)).
66. In re Carey, 938 F.2d 1073 (10th Cir. 1991).
67. *Id.* at 1075.

commenced with a quote from an Eighth Circuit opinion stating: "[T]he conversion of non-exempt to exempt property for the purpose of placing the property out of reach of creditors, without more, will not deprive the debtor of the exemption to which he otherwise would be entitled."[68] Furthermore, Congress had determined that a debtor should be permitted to convert nonexempt property into exempt property before filing a bankruptcy petition, that the practice was not fraudulent as to creditors, and that it permits the debtor to make full use of the exemptions to which it is entitled under the law.[69]

The appellant wanted the court to deny Carey a discharge in that the activities complained of constituted fraudulent conveyances.[70] Citing varying authorities, the court outlined certain fundamental rules about transfers to hinder, delay or defraud. To deny a discharge under 11 U.S.C. § 727(a)(2), a court must find actual intent to defraud creditors. The desire to convert assets into exempt forms by itself does not constitute actual intent to defraud. Extrinsic evidence of fraudulent intent is required, although fraudulent intent to conceal assets may be established by circumstantial evidence, or by inferences drawn from a course of conduct. Judge Logan's opinion noted that the cases are peculiarly fact specific. He indicated that the bankruptcy court had found that Carey's actions were not fraudulent and concluded that, on the facts, the Code sections require more evidence than Marine Midland offered.[71] The lower court decisions were affirmed.

VI. Administration of the Case

A. *Involuntary Petitions*

Section 303 of the Bankruptcy Code governs petitions for involuntary bankruptcy. Among other provisions therein, creditors are prohibited from indiscriminately filing an involuntary petition against a debtor. When a bankruptcy court dismisses a petition for involuntary bankruptcy, the debtor may recover costs under certain circumstances. In the case of a bad faith filing, it may also recover damages from the petitioning creditors. A strangely worded subsection of section 303 caused unnecessary litigation and a thorny interpretive problem for the Tenth Circuit in *In re Peterson.*

68. *Id.* at 1076 (quoting Norwest Bank of Neb., N.A. v. Tveten, 848 F.2d 871, 873-74 (8th Cir. 1988)).

69. *Id.* (citing H.R.Rep. No. 595, 95th Cong., 1st Sess. 361 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6317; S.Rep. No. 989, 95th Cong., 1st Sess. 361 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News at 5862).

70. *Id. See* 11 U.S.C. § 727(a)(2) (1988) which provides, "(a) The court shall grant the debtor a discharge, unless — . . . (2) the debtor, with intent to hinder delay, or defraud a creditor . . . has transferred, . . . or concealed — (A) property of the debtor within one year before the date of the filing of the petition. . . ."

71. *Id.* at 1077.

1. Conditions for Recovery of Damages for Bad Faith Filings: *In re R. Eric Peterson Const. Co.*

In September 1986, Quintek, Inc. (Quintek) petitioned to place R. Eric Peterson Construction Co. (Peterson) in involuntary bankruptcy pursuant to 11 U.S.C. § 303.[72] Quintek's counsel sent letters to all of Peterson's subcontractors informing them of the involuntary petition. The publicity, along with the filing, allegedly had a disastrous effect on the financial viability of the company. Peterson opposed the petition, alleging it had paid its bills on time, that the creditor's claims were subject to bona fide disputes and that the petition had been filed without adequate investigation of the company's financial status.

At the hearing on creditors' motion to dismiss the petition, and in response to the court inquiry into whether Peterson would consent to the dismissal, Peterson's counsel responded that the debtor:

> [w]ould like to indicate a reservation. The debtor does not object to the petition being dismissed, but it is the debtor's feeling that this petition was filed in bad faith and it wishes to assert a claim under 303([i]). And we would like to reserve the right, if we would go along with the dismissal, subject to reserving in the Court's jurisdiction [sic] and the right to have the bad faith claim adjudicated under 303([i]).[73]

The court dismissed the petition but retained jurisdiction to determine the debtor's bad faith filing claim.

Summarizing the rather complicated procedural facts, for the purposes of this Article, the bankruptcy court granted the creditors summary judgment on debtor's claim of bad faith filing and the District Court, on its own motion, determined that the debtor's consent to dismissal deprived the bankruptcy court of jurisdiction of the debtor's good faith claim.[74] Thus, the issue in the debtor's appeal to the Tenth circuit was whether the debtor consented to dismissal even though it had specifically reserved a claim for the bad faith filing.

Without questioning why the obviously awkwardly worded statute would so require[75], the Tenth Circuit opinion outlined its three requirements, namely: (1) dismissal of the petition, (2) something other than consent of all petitioning creditors and the debtor and (3) non-waiver of

72. In re Eric R. Peterson Const. Co., 951 F.2d 1175 (10th Cir. 1991).

73. *Id.* at 1177. *See also* 11 U.S.C. § 303(i) (1988):

> (i) If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment —
> (1) against the petitioners and in favor of the debtor for —
> (A) costs; or
> (B) a reasonable attorney's fee; or
> . . .
> (2) against any petitioner that filed the petition in bad faith, for —
> (A) any damages proximately caused by such filing; or
> (B) punitive damages.

Id.

74. 951 F.2d. at 1177-78.

75. *See supra* note 73.

the debtor of its right to recover damages for bad faith filing.[76] In other words, the statute requires *both* non-consent to dismissal *and* non-waiver of the debtor's right to damages.

The issue in *Peterson* turns on whether the debtor consented to dismissal of the bankruptcy petition when it did not object to the creditors' voluntary dismissal of the bankruptcy petition — even though at the same time it specifically reserved a claim against the creditors under section 303(i) for alleged bad faith filing of the bankruptcy petition. The Tenth Circuit opinion attached a common sense meaning to the word "consent." It reasoned that the debtor should not be required to actively oppose dismissal of an involuntary bankruptcy in order to preserve a claim for damages under 303(i) if that petition was wrongfully brought.[77] The court held that, as a matter of law, Peterson did not consent to dismissal within the meaning of section 303(i). It reversed and remanded the case to the district court for consideration of Peterson's appeal of the bankruptcy court's summary judgment determination on the bad faith issue.[78]

B. *Treatment of Secured Claims*

The treatment of secured claims in bankruptcy has become one of the topics much litigated in the shakedown following the enactment of the 1978 Bankruptcy Code and the 1984 Amendments. Three Tenth Circuit cases, two of which have been to the Supreme Court, are included in this survey. These cases actually involved the so-called "Chapter 20" filings. A number of debtors have been filing a straight bankruptcy under Chapter 7 followed by a rehabilitative case under Chapter 13. The extent to which a debtor may combine some advantages of each chapter is presently unclear as the cases to be discussed indicate.

1. "Lien Stripping": *In re Dewsnup*

The Tenth Circuit, in *In re Dewsnup*[79], was faced with a difficult interpretive problem involving section 506. The Dewsnups borrowed money secured by a deed of trust covering farmland. After default, foreclosure proceedings were interrupted by the pendency of bankruptcy proceedings. Following an aborted Chapter 11 proceeding, petitioners sought liquidation under Chapter 7 and attempted to strip the lien through the use of provisions of section 506. The bankruptcy court determined the value of the land to be $39,000; the debt was over $100,000.

Often, secured parties in bankruptcy are undersecured. That is, the value of the collateral is less than the debt. Section 506(a) recognizes this fact and provides that the creditor is a secured creditor to the extent

76. 951 F.2d at 1179.
77. *Id.* at 1180.
78. *Id.* at 1182.
79. In re Dewsnup, 908 F.2d 588 (10th Cir. 1990).

of the value of the collateral and an unsecured creditor for the excess amount of the debt.[80] However, section 506 further provides in subsection (d) that, insofar as a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void.[81] The Dewsnups argued that under a literal reading of this language, the lender's lien should be disallowed except to the extent of the present value of the land which was $39,000. The effect of this application of the language, in the words of Mr. Justice Blackmun in the case on appeal, was that "the creditor would lose the benefit of any increase in the value of the property by the time of the foreclosure sale."[82]

After the bankruptcy court denied the petitioner's request and the district court affirmed, the Tenth Circuit also affirmed. The Tenth Circuit's decision was based upon the questionable conclusion that because the trustee would abandon the asset, the estate had no interest in the asset as abandoned property. Because of a split among circuits on the lien stripping issue, the Supreme Court granted certiorari and rendered an opinion on January, 15, 1992.[83] Over the dissent of Scalia and Souter, who would apply the clear language of section 506(d),[84] the Supreme Court reversed the Tenth Circuit and remanded. The majority opinion (Thomas, J., not participating) ruled that inasmuch as the Bankruptcy Code does "embrace some ambiguities,"[85] the section "does not allow petitioner to 'strip down' respondents' lien."[86] Unfortunately, in deciding the case on the presumed intent of Congress not to change the law on this point in the enactment of the 1978 Code, the opinion admitted that the holding is of limited application.[87] Bankruptcy lawyers would probably agree with the assumption that Congress did not intend the strip down effect of section 506(d). Lawyers and jurisprudential types will probably continue to disagree on whether the dissent's approach is a desirable one.

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80. 11 U.S.C. § 506, Determination of secured status, which states in pertinent part:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.

81. 11 U.S.C. § 506(d).

82. Dewsnup v. Timm, 112 S. Ct. 773, 778 (1992).

83. *Id.*; Dewsnup v. Timm, 111 S. Ct. 949 (1991).

84. 11 U.S.C. § 506(d):

> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—
>
> (1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
>
> (2) such claim is not an allowed secured claim due only to the failure of an entity to file a proof of such claim under section 501 of this title.

85. 112 S. Ct. 773, 777.

86. *Id.* at 778.

87. "Hypothetical applications that come to mind and those advanced at oral argument illustrate the difficulty of interpreting the statute in a single opinion that would apply to all possible fact situations. We therefore focus upon the case before us and allow other facts to await their legal resolution on another day. *Id.* at 778.

2. "Bifurcation" of Secured Claims: *In re Hart*

One important provision of 11 U.S.C. § 1322(b)(2)[88] permits a Chapter 13 plan to modify a secured claim. The home mortgage industry convinced Congress to make an exception to that rule in their favor[89] and the present version provides that the plan may modify the rights of holders of secured claims, other than a claim "secured only by a security interest in real property that is the debtor's principal residence."[90] A recent Tenth Circuit case, *In re Hart*, presented the question of whether the bifurcation of a claim into a secured claim and an unsecured claim under section 506(a) was permissible where a mortgage on the debtor's residence was undersecured.[91] The Harts attempted a bifurcation in their Chapter 13 plan where the mortgage secured a $55,000 indebtedness and the fair market value of the property was stipulated to be $30,000. Recognizing the bifurcation of the claim would mean that the unsecured portion of the claim would not be subject to the section 1322(b)(2) limitation, the creditor objected. The district court reversed the bankruptcy court's approval of the plan and the Harts appealed to the Tenth Circuit.

The Tenth Circuit agreed with the bankruptcy court that the plan could bifurcate the creditor's claim. The majority opinion (a per curiam opinion of JJ. Moore and Tacha, even though J. Brorby dissented) noted the split of authority among the circuits.[92] The courts differ basically on balancing the extent of the protection afforded such creditors by Congress against the effect of the clear use of the terms "secured claim" and "unsecured claim" in section 1322. The court opinion found nothing in the language of the section necessitating going beyond the statutory definition of secured claim, "to protect the unsecured portion of an under-

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88. 11 U.S.C. § 1322(b)(2):

> (b) Subject to subsections (a) and (c) of this section, the plan may—
>
> . . .
>
> (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;
>
> . . . .

89. *See* discussion of the legislative history, In re Hart, 923 F.2d 1410, 1412 (10th Cir. 1991).

90. *Id.* (citing Gruggs v. Houston First Am. Sav. Ass'n, 730 F.2d 236)( ).

91. 923 F.2d 1410 (10th Cir. 1991) and 11 U.S.C. § 506(a) which states:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

92. *See* cases cited in In re Hart, 923 F.2d at 1414. According to the opinion, the Third and Ninth Circuits allow bifurcation while the Fifth, Eighth and Eleventh Circuits treat it as inappropriate in Chapter 13 proceedings.

secured home mortgage."[93] The dissent, without elaboration, concluded that this approach "renders section 1322(b)(2) essentially meaningless."[94]

3. Secured Claims in Chapter 13: *In re Johnson*

One question resulting from a "Chapter 20" bankruptcy was answered by the Supreme Court in a case coming from the Tenth Circuit.[95] In an attempt to increase the use of Chapter 13 by individual debtors, section 1322(b)(2) permits a plan for adjustment of debts under that chapter to modify the rights of holders of secured claims.[96] Johnson took steps after Home State Bank started to foreclose a mortgage on his farm property. First, he filed for a liquidation under Chapter 7 and as a result of this action, he was discharged from personal liability on the promissory notes to the bank. The bank still had a right to proceed *in rem* against the real estate and re-initiated foreclosure, obtaining an *in rem* judgment. Prior to the foreclosure sale, the petitioner completed the "Chapter 20" filing by filing under Chapter 13, staying the foreclosure sale.

In the Chapter 13 proceeding, Johnson listed the bank's mortgage on the farm as a claim against the estate and, under the plan, proposed to pay the bank in four annual installments and a final balloon payment totalling the amount of the bank's in rem judgment. The bankruptcy court confirmed the plan over the bank's objection. The bank appealed to the district court arguing that (1) the debtor could not modify its mortgage obligations under a Chapter 13 plan where the personal liability had already been discharged in a Chapter 7 case, and (2) that the court erred in finding that the plan was in good faith and feasible. The district court agreed with the bank on the first point and the Tenth Circuit Court of Appeals affirmed. The Tenth Circuit disagreed with two other circuit courts,[97] and held that Congress did not intend such a claim to be treated in a Chapter 13 plan even though the definition of "claim against the debtor" in 11 U.S.C. § 102(2) "includes claim against property of the debtor."[98] Because of the split between the circuits, the Supreme Court granted certiorari in the *Johnson* case,[99] and reversed the Tenth Circuit.[100]

Justice Marshall delivered the opinion of the unanimous Court.[101] After examining the Code's use of the word "claim" throughout the Code and citing its decisions adopting "the broadest available definition

93. *Id.* at 1415.
94. *Id.* at 1417.
95. In re Johnson, 904 F.2d 563 (10th Cir. 1990).
96. 11 U.S.C. § 1322(b)(2).
97. *See* In re Saylors, 869 F.2d 1434, 1436 (11th Cir. 1989); In re Metz, 820 F.2d 1495, 1498 (9th Cir. 1987).
98. 904 F.2d 563, 565.
99. 111 S. Ct. 781 (1991).
100. Johnson v. Home State Bank, 111 S. Ct. 2150 (1991).
101. The congruence between a "plain meaning" result and a perceived "intent of Congress" result may be one explanation of the unanimous result.

of 'claim,' "[102] the court discussed the bank's claim that "[s]erial filings under Chapter 7 and Chapter 13 . . . evade the limits that Congress intended to place on these remedies."[103] The opinion disagreed with this argument, reasoning that Congress had expressly prohibited certain forms of serial filings and therefore not this one.[104] The Court left to a remand the issue of whether the plan was proposed in "good faith" under section 1325(a)(3).[105] One expected issue to be settled following this case is the judicial reaction to a claim that a serial filing of Chapter 7 followed by Chapter 13 in a foreclosure setting as was true in *Johnson* is, per se, a bad faith plan.[106]

VII. Trustee Avoidance Powers

Inasmuch as a filing of the petition in bankruptcy operates to stay creditor activity, the bankruptcy trustee is given certain substantive powers which benefit all of the creditors. The three powers most often litigated are the "strong arm" power under section 544, the power to avoid certain preferences under section 547 and the power to set aside fraudulent conveyances under section 548. This survey includes one case from each of these areas. The reader is also reminded that the *Carey* case, discussed above under the topic of Debtor's Exempt Property, included a discussion of pre-petition transfers to improve one's exemptions and the extent to which such transfers were fraudulent conveyances.

A. *The "Strong Arm" Power*

The power of the trustee to avoid pre-petition transfers under section 544 is often called the "strong arm" power since the power of avoidance is sometimes exercised even though no actual creditor could have acted. The following case illustrates the operation of the section in the context of a real estate transfer.

1. Hypothetical Bona Fide Purchaser: *Watkins v. Watkins*

The strong arm power of the trustee under section 544(a) is a hypothetical lien creditor power under (a)(1) and (a)(2), and a hypothetical bona fide purchaser power under (a)(3).[107] Under the latter subsection,

102. 111 S. Ct. at 2154.

103. *Id.* at 2156.

104. *Id.*

105. 11 U.S.C. § 1325(a): Except as provided in subsection (b), the court shall confirm a plan if . . . (3) the plan has been proposed in good faith and not by any means forbidden by law. *See also* In re Johnson, 940 F.2d 609 (10th Cir. 1991).

106. *See* the opinion in the original *Johnson* case in the Tenth Circuit and citation of cases at 904 F.2d at 565. That opinion seems to treat serial filing and the listing of a discharged claim as a bad faith plan.

107. 11 U.S.C. §§ 544(a)(1),(2) and (3):

> (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—
>
> (1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to

applied in *Watkins v. Watkins*,[108] the trustee may avoid a pre-bankruptcy transfer of the debtor's property if such transfer under state law were ineffective as against a bona fide purchaser "whether or not such a purchaser exists."[109]

Janet and Gregory Watkins were divorced in Oklahoma in 1986. One of the assets, owned jointly, was a tract of commercial real property containing Gregory's office. The divorce decree set aside this asset to him and also imposed a lien on the property to secure his obligation to pay alimony. Subsequently, Gregory filed a petition in bankruptcy which prompted Janet to file a copy of the divorce judgment as a lien in the county clerk's office. Gregory sought to avoid the lien under section 544(a)(3) on the ground that Janet had not perfected her lien at the time of the bankruptcy petition. The bankruptcy court invalidated the lien; the district court affirmed and Janet appealed.

The Tenth Circuit reversed on a determination that under Oklahoma law, a bona fide purchaser would take subject to the constructive notice provided by the divorce judgment.[110] That judgment, which was the source of the ex-husband's sole title, also contained the limitation of that title, the ex-wife's lien.

B. *Fraudulent Conveyances*

1. Fraudulent Conveyances: *In re Kaiser Steel Corp.*

An interesting question involving the trustee power to recover property which was arguably the subject of a fraudulent conveyance was finessed in *In re Kaiser Steel Corp.*,[111] when the court applied another section of the Bankruptcy Code. Kaiser Steel Corporation was the subject of a leveraged buyout ("LBO") in which its former shareholders were the recipients of cash and new shares. Sometime after the LBO, the new entity, Kaiser Steel Resources, Inc., went into Chapter 11 proceedings and promptly attempted to recover as fraudulent conveyances the payments made as a result of the LBO. Various defendants made the argument that the payments were "settlements" under section 546(e)[112] and

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such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

108. 922 F.2d 1513 (10th Cir. 1991).

109. 11 U.S.C. § 544(a)(3).

110. 922 F.2d at 1514-15.

111. 952 F.2d 1230 (10th Cir. 1991).

112. 11 U.S.C. § 546(e):

(e) Notwithstanding sections 544, 545, 547, 548(a)(2), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in non-recoverable. In an earlier appeal,[113] the court held that payments to financial intermediaries were protected by the "settlement" exception. Thus, *Kaiser* involved only the issue of whether the *Schwab* holding should be extended to protect payments made to the shareholders. Section 546(e) exempts from the trustee's avoiding powers "a transfer that is a margin payment, . . . or settlement payment, as defined in section 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency . . . ." "Settlement payment" is defined in section 741(8) as: "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade . . . ."[114]

The debtor-in-possession naturally argued that these definitions only protected intermediaries in the process of using brokers, margin accounts and other organizations in the securities market. The defendant shareholder and the Securities Exchange Commission ("SEC")[115] argued for an all-inclusive protection of the securities markets including shareholders. The latter argument was accepted by the Tenth Circuit[116] and unless the Supreme Court settles the question otherwise, the fascinating law of LBO's as fraudulent conveyances must await another forum.

C. *Voidable Preferences*

Certain transfers of property of the debtor to creditors made within an arbitrary period of time, ninety days for most purposes, are avoidable by the trustee under 11 U.S.C. § 547. The purpose of avoiding these preferences (which are neither generally nor necessarily fraudulent conveyances or otherwise bad under state law) is at least twofold. One accepted purpose is to increase the amount of *pro rata* sharing that takes place in the bankruptcy process and another is to inhibit creditors from participating in a rush to the courthouse door which might unnecessarily force a debtor into failure.

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section 101(34), 741(5), or 761(15) of this title, or settlement payment, as defined in section 101(35) or 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title.

113. Kaiser Steel Corp. v. Charles Schwab & Co., 913 F.2d 846 (10th Cir. 1990).

114. 11 U.S.C. § 741(8) (1988).

115. One may wonder why the SEC would assist the shareholders in so interpreting the definition of "settlement payment" so as to preempt a determination of whether certain LBO's might not be fraudulent conveyances. An examination of the SEC's brief in the instant case sheds some light on the matter. Much of the brief argues that there is no reason in the language of the statute to exclude payments by brokers *to* shareholders. Discussing policy concerns, the brief states: "Investor confidence (in the securities market) would be undermined if investors could be forced to give up payments received years earlier in settled transactions." SEC brief at p. 17.

116. 952 F.2d at 1241.

1. Time of Transfer in Payment by Check: *In re Antweil*

Much of the complexity of voidable preference law under section 547 involves an interaction of state and federal law. A recent decision of the Tenth Circuit, now under review by the Supreme Court, is an illustration of this complexity.

The issue in *In re Antweil*,[117] can be simply put. In the case of payment of a debt by a check, does a transfer under section 547 occur when the check is delivered or when the check is honored by the drawee bank? Obviously, the beginning of the 90 day period is unknown at the time it occurs. One cannot predict the timing of a future filing of a petition. However, after the event it becomes important to identify whether a debt paid by check is paid when the check is delivered to the creditor or when it is paid by the drawee bank.

In the *Antweil* case, debtors delivered a check on the 91st day prior to bankruptcy and it was honored by the drawee bank within the 90 day period. If the transfer of property of the debtor occurred when the check was delivered, there was no preference within the suspect period. In reversing the district court's holding that the transfer occurred upon delivery, the Tenth Circuit joined the Seventh and Eleventh Circuits[118] in ruling that the transfer did not occur until the check was honored or paid by the drawee bank and therefore a transfer occurred within the ninety day period.[119] The Supreme Court granted review[120] and recently affirmed the Tenth Circuit holding.[121]

2. Payments Made in the Ordinary Course of Business: *Union Bank v. Wolas* (Supreme Court)

A 1991 decision of the U.S. Supreme Court is noted in this Survey because of its significance to certain Tenth Circuit cases discussed herein.[122]

The 1978 Bankruptcy Code included an extensive rewrite of the law of preferences. Section 547(c)[123] includes a number of transactions which are not avoidable by the trustee even though otherwise they would meet the definition of preference set forth in section 547(c). Congress recognized that certain payments made by a debtor in the usual course of business were definitionally preferences, such as monthly payments for utility services, rent, etc. Hence, section 547(c)(2) provides that the trustee may not avoid a transfer:

(2) to the extent that such transfer was—
(A) in payment of a debt incurred by the debtor in the ordinary

117. 931 F.2d 689 (10th Cir. 1991).
118. According to the court's opinion, the Sixth and Ninth Circuits have held otherwise. *See* cites in 931 F.2d at 695.
119. 931 F.2d at 695.
120. Barnhill v. Johnson, 112 S. Ct. 48 (1991).
121. Barnhill v. Johnson, No. 91-159, 1991 U.S. LEXIS 1955 (U.S. Mar. 25, 1992).
122. Union Bank v. Wolas, 112 S. Ct. 527 (1991).
123. *See supra* note 11.

course of business or financial affairs of the debtor and the transferee;
(B) made not later than 45 days after such debt was incurred;
(C) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
(D) made according to ordinary business terms.

In the 1984 amendments, Congress repealed the 45 day limitation without otherwise changing the subsection.[124] The effect of this latter amendment was an issue in *Union Bank v. Wolas.*[125]

ZZZZ Best Co. borrowed seven million dollars from Union Bank and, during the ninety day period before ZZZZ Best filed for bankruptcy, it made two interest payments to the bank. The bankruptcy court determined that such payments came within the ordinary course of business exception and the district court affirmed. The Ninth Circuit reversed on the basis of policies underlying the Code and the Supreme Court granted certiorari[126] to resolve a split on the issue with the Sixth Circuit.[127]

Wolas, the trustee, argued that the exception did not apply to payments made by the debtor on long term debt. Applying a plain meaning of the words approach to the statute as amended, Justice Stevens' opinion (Justice Scalia, concurring) held that there was no reason to find such a limitation to the exception. The Ninth Circuit decision was reversed.[128]

The importance of the decision in the *Wolas* case can only be assessed by subsequent cases. Many routine preference questions will need to be reexamined in the light of this case. For example, the payments made to depositors in the *Republic Bank* case, discussed above,[129] were assumed to be voidable preferences. After *Wolas*, transferees will argue that such payments were made in the "ordinary course of business" of the debtor. A cynical reader of the *Wolas* decision might feel that much of the voidable preference power of the trustee disappeared in the process.

VIII. Discharge

One of the purposes and policies of the Federal Bankruptcy Code is to afford the debtor a "fresh start." Many debtors file for bankruptcy with the purpose of obtaining a discharge from pre-bankruptcy obligations. One continuing debate with respect to bankruptcy law issues is the extent to which the discharge feature is abused. Section 523 of the Code provides a number of bases for excepting certain debts from discharge and section 727 outlines certain acts which will constitute

124. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 98-353, § 462(c), 98 Stat. 333, 378.
125. 60 U.S.L.W. 4043, 4044-45 (U.S. Dec. 10, 1991).
126. Union Bank v. Wolas, 111 S. Ct. 2009 (1991).
127. In re Finn, 909 F.2d 903 (6th Cir. 1990).
128. 60 U.S.L.W. at 4046.
129. *See supra* note 7.

grounds for denying a discharge altogether. Several Tenth Circuit cases involve this important topic of the discharge.

A. *Collateral Estoppel and Burden of Proof:* In re Tsamasfyros

In *Brown v. Felsen*,[130] the Supreme Court considered the extent to which a non-bankruptcy court determination of facts, constituting grounds for non-dischargeability of a debt in bankruptcy, could be used in bankruptcy proceedings. The actual case involved a possible issue of res judicata, but in a footnote, the opinion indicated that similar results might follow from application of the principle of collateral estoppel.[131]

The Tenth Circuit applied this footnote dicta in *In re Tsamasfyros.*[132] The bankrupt had been sued in state court and that court, after a four-day trial, entered judgment for the plaintiff in the sum of over $150,000. In a written order, the judge held that the bankrupt's "actions in breaching his fiduciary duties were attended by circumstances of fraud and by a wanton or reckless disregard of [plaintiff's] rights and feelings."[133] Within a month after this judgment, Tsamasfyros filed a petition in bankruptcy and the successful plaintiff filed a complaint to determine the dischargeability. The bankruptcy judge's order of non-dischargeability under 11 U.S.C. § 523(a)(2)(A),[134] using the state court finding, was upheld by the district court and appealed to the Tenth Circuit.

The Tenth Circuit's affirmance of the decisions outlined a few matters of importance in applying the collateral estoppel rule. The appellant's argument that a state court determination of fraud would not equate with a bankruptcy determination because of a different standard of proof became unmaintainable given the nearly contemporaneous decision of the Supreme Court in *Grogan v. Garner.*[135] In that case, it was held that a "preponderance of the evidence" rather than a "clear and convincing evidence" standard applies to all exceptions to dischargeability of debts set forth in 11 U.S.C. § 523.[136] The Tenth Circuit also held that the fact that Tsamasfyros appeared *pro se* in the state court proceedings on the facts, did not render collateral estoppel irrelevant.[137]

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130. 442 U.S. 127 (1979).
131. *Id.* at 139, n.10.
132. 940 F.2d 605 (10th Cir. 1991).
133. *Id.* at 605.
134. 11 U.S.C. § 523(a)(2)(A):

> (a) A discharge under section 727, 1141, 1228(a), 1228(b),or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> . . .
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> . . . .

135. 111 S. Ct. 654 (1991).
136. *Id.* at 659.
137. 940 F.2d at 607.

B. Section 727 and Burden of Proof: *In re Serafini*

As just indicated, the Supreme Court decision in *Grogan v. Garner* involved a ground for denial of dischargeability under section 523. Another 1991 Tenth Circuit case applied the reasoning of *Grogan* to a section 727 case. *In re Serafini*[138] began as an adversary proceeding brought by a creditor to deny a Chapter 7 debtor of the discharge based upon his alleged fraudulent transfer, removal, destruction, mutilation or concealment of assets under 11 U.S.C. § 727(a)(2).[139] The bankruptcy court dismissed the complaint and the district court affirmed on the grounds that the creditor had not met its burden of proof by the requisite clear and convincing evidence.[140] Subsequent to the date of the judgment of the district court, the Supreme Court decided the *Grogan* case, supra. The Tenth Circuit, McWilliams, J., held that even though that case was a section 523 case, the same logic applied to denial of discharge under section 727.[141]

One can speculate as to the general acceptability of *Serafini*'s extension of *Grogan* to section 727 by analogy. The opinion by Justice Stevens in the *Grogan* case discussed the fact that the grounds for precluding application of the discharge to certain debts under section 523 were related to state created causes of action which might have a different burden of proof. In cases involving possible application of the doctrine of collateral estoppel, the opinion noted, reduction of litigation would follow from the same standard for burden of proof. This consideration seems to have much less weight or relevance in the context of the grounds from the denial of a discharge set out in section 727. This reviewer predicts that a split will develop among the circuits on this issue.

C. Dischargeability of Taxes and Penalties: *In re Bergstrom*

Bankrupt failed to file income tax returns for certain pre-petition tax years and following bankruptcy proceedings the IRS served delinquency notices on Bergstrom.[142] Debtor filed a motion to reopen the case to determine the dischargeability of the tax liability and the bankruptcy court denied the motion. A hearing was held in the district court which affirmed the bankruptcy court. In the Tenth Circuit, Bergstrom contended that, since the tax liability was determined through "substi-

138. 938 F.2d 1156 (10th Cir. 1991).

139. 11 U.S.C. § 727(a)(2):

(a) The court shall grant the debtor a discharge, unless—

. . .

(2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—

(A) property of the debtor, within one year before the date of the filing of the petition; or

(B) property of the estate, after the date of the filing of the petition;

. . . .

140. 938 F.2d at 1156.

141. *Id.* at 1157.

142. In re Bergstrom, 949 F.2d 341 (10th Cir. 1991).

tute filings" made by the commissioner, and since such filings were "prima facie good and sufficient for all legal purposes" according to 26 U.S.C. § 6020(b)(2), such liabilities did not come within the exception from discharge provided in 11 U.S.C. § 523(a)(1)(B).[143] The Tenth Circuit (Barrett, Senior Circuit Judge) had no problem holding that a substitute form for the purpose of the Internal Revenue Code was not a filed form for the purposes of the 1978 Bankruptcy Code.[144]

D. Protection of the Discharge: *In re Walker*

While *In re Walker*,[145] involved little new law, the application of existing principles is instructive. The Higleys filed suit against real estate agent Ralph Walker and others in Utah state court for Walker's alleged deceptive appropriation of funds from the Higleys during a consumer real estate transaction. The proceeding was halted temporarily when Walker filed a Chapter 11 petition in bankruptcy court in Utah, but resumed when that petition was dismissed. Walker did not attend the resumed proceedings because he intended to refile for bankruptcy. Formal entry of judgment for the Higleys did not occur until after Walker's Chapter 7 petition was filed. Walker received a discharge.

After learning that Walker had declared bankruptcy, the Higleys petitioned the state district court for an order directing payment of their judgment out of Utah's Real Estate Recovery Fund (Fund), a monetary fund established by the State of Utah to satisfy judgments against real estate licensees in actions based on fraud, misrepresentation or deceit committed in real estate transactions. The state district court granted the Higleys' petition and the State of Utah complied with the court's order by paying the Higleys. Subsequently, Walker filed a motion in Utah state court to vacate the judgment against him, alleging that the judgment was void because it was entered after the section 362(a) automatic stay had gone into effect. On November 16, 1987, Walker filed an adversary proceeding against the Higleys and their attorney, claiming violation of the Bankruptcy Code's automatic stay provisions and seeking damages under 11 U.S.C. § 362(h).[146]

Meanwhile, the Utah Supreme Court ruled that the state court judgment was void, having been entered after the filing of the petition in bankruptcy, and the judgment was vacated.[147] Thereupon, the Utah Attorney General requested that the state court order the Higleys to repay

143. 11 U.S.C. § 523(a)(1)(B), which reads in pertinent part:

(a) A discharge under section 727 . . . does not discharge an individual debtor from any debt -

(1) for a tax . . .

(B) with respect to which a return, if required-

(i) was not filed . . . .

144. *Id.* at 343.

145. 927 F.2d 1138 (10th Cir. 1991).

146. 11 U.S.C. § 362(h) states: An individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorney's fees, and, in appropriate circumstances, may recover punitive damages.

147. 927 F.2d at 1141.

the Fund the sum previously paid to them in satisfaction of the now-void judgment. The Higleys responded to the recovery efforts of the Utah Attorney General by filing various motions in the bankruptcy court intended to confirm their right to the monies received from the Fund. The bankruptcy court denied each of these motions.[148] The Higleys appealed the bankruptcy court denials of their motions for relief from the post-discharge injunction or for an extension of time in which to determine the dischargeability of their claim against Walker. The district court affirmed the bankruptcy court[149] and the Higleys appealed to the Tenth Circuit Court of Appeals.

The Tenth Circuit decision is of interest in this survey because of the court's discussion of the effect and purposes of the post-discharge injunction provided by 11 U.S.C. § 524 (a)(2).[150] The injunction prevents the commencement or continuation of an action, the employment of a process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived. The intent of this post-discharge injunction is to protect debtors like Walker in their financial fresh start following discharge.

The court (Judge Logan) indicated that section 524 further provides that discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity, for such debt.[151] This latter provision permits a creditor to bring or continue an action directly against the debtor for the purpose of establishing the debtor's liability when, as here, establishment of that liability is a prerequisite to recovery from another entity. Since, in this case, the Higleys sought to continue their state court action against Walker for the sole purpose of confirming their right to the Fund monies previously paid to them, the Court of Appeals found no basis for the lower courts' determination that the Higleys' efforts to renew this action threatened Walker's financial fresh start.[152]

The court found no reason to reverse the denial of the Higleys' motion for an extension of time in which to challenge the dischargeability of their claim against Walker. A complaint against discharge of a creditor's claim must be filed within 60 days after the first meeting of creditors,[153] 11 U.S.C. § 523(c) and Bankruptcy Rule 4007(c).[154] In this case

148. *Id.*

149. *Id.*

150. 11 U.S.C. § 524(a)(2):

> (a) A discharge in a case under this title—
>
> (2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such a debt is waived;
>
> ....

151. 927 F.2d at 1142. 11 U.S.C. § 524(e) states: Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.

152. 927 F.2d at 1143.

153. *Id.* at 1144.

154. 11 U.S.C. § 523(c) states:

the Higleys had actual knowledge of the bankruptcy case in time to proceed.

IX. Conclusion

A number of comments follow from a study of the Tenth Circuit's busy year with bankruptcy cases. The structure of the 1978 Bankruptcy Code is complex. Congress was reacting to many policy issues in the process of reforming bankruptcy law and many policy issues were incompletely resolved, arguably, even in the 1984 Amendments. This observer predicts a continued flow of cases to the Tenth Circuit asking for clarification of these issues. There does not appear to be any discernible "trend" in the Tenth Circuit cases.

The Tenth Circuit tends not to be a pro-debtor bankruptcy court, but there are really no simple answers to many of these issues. There will continue to be splits in the circuits. One might also predict continuing Supreme Court activity to resolve such splits. It is unlikely that Congress will act soon to simplify the judicial task of applying this mammoth statute. A final comment — history repeats itself in the sense that the prior Bankruptcy Act required constant judicial interpretation and one can expect the same for the current 1978 Bankruptcy Code.

Neil O. Littlefield,
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(c) Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), or (6) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6), as the case may be, of subsection (a) of this section.

Bankruptcy Rule 4007(c), 11 U.S.C. § states:

(c) Time for Filing Complaint Under § 523(c) in Chapter 7 Liquidation, Chapter 11 Reorganization, and Chapter 12 Family Farmer's Debt Adjustment Cases; Notice of Time Fixed.

A complaint to determine the dischargeability of any debt pursuant to § 523(c) of the Code shall be filed not later than 60 days following the first date set for the meeting of creditors held pursuant to § 341(a). The court shall give all creditors not less than 30 days notice of the time so fixed in the manner provided in Rule 2002. On motion of any party in interest, after hearing on notice, the court may for cause extend the time fixed under this subdivision. The motion shall be made before the time has expired.

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