Commercial Law and Bankruptcy: Year in Review

June 10, 2019

3:30 p.m. – 5:30 p.m.

Connecticut Convention Center
Hartford, CT

CT Bar Institute Inc.

CT: 2.0 CLE Credits (General)
NY: 2.0 CLE Credits (AOP)

Seminar Materials Sponsored by

Lawyers' Principles of Professionalism

As a lawyer I must strive to make our system of justice work fairly and efficiently. In order to carry out that responsibility, not only will I comply with the letter and spirit of the disciplinary standards applicable to all lawyers, but I will also conduct myself in accordance with the following Principles of Professionalism when dealing with my client, opposing parties, their counsel, the courts and the general public.

Civility and courtesy are the hallmarks of professionalism and should not be equated with weakness;

I will endeavor to be courteous and civil, both in oral and in written communications;

I will not knowingly make statements of fact or of law that are untrue;

I will agree to reasonable requests for extensions of time or for waiver of procedural formalities when the legitimate interests of my client will not be adversely affected;

I will refrain from causing unreasonable delays;

I will endeavor to consult with opposing counsel before scheduling depositions and meetings and before rescheduling hearings, and I will cooperate with opposing counsel when scheduling changes are requested;

When scheduled hearings or depositions have to be canceled, I will notify opposing counsel, and if appropriate, the court (or other tribunal) as early as possible;

Before dates for hearings or trials are set, or if that is not feasible, immediately after such dates have been set, I will attempt to verify the availability of key participants and witnesses so that I can promptly notify the court (or other tribunal) and opposing counsel of any likely problem in that regard;

I will refrain from utilizing litigation or any other course of conduct to harass the opposing party;

I will refrain from engaging in excessive and abusive discovery, and I will comply with all reasonable discovery requests;

In depositions and other proceedings, and in negotiations, I will conduct myself with dignity, avoid making groundless objections and refrain from engaging I acts of rudeness or disrespect;

I will not serve motions and pleadings on the other party or counsel at such time or in such manner as will unfairly limit the other party's opportunity to respond;

In business transactions I will not quarrel over matters of form or style, but will concentrate on matters of substance and content;

I will be a vigorous and zealous advocate on behalf of my client, while recognizing, as an officer of the court, that excessive zeal may be detrimental to my client's interests as well as to the proper functioning of our system of justice;

While I must consider my client's decision concerning the objectives of the representation, I nevertheless will counsel my client that a willingness to initiate or engage in settlement discussions is consistent with zealous and effective representation;

Where consistent with my client's interests, I will communicate with opposing counsel in an effort to avoid litigation and to resolve litigation that has actually commenced;

I will withdraw voluntarily claims or defense when it becomes apparent that they do not have merit or are superfluous;

I will not file frivolous motions;

I will make every effort to agree with other counsel, as early as possible, on a voluntary exchange of information and on a plan for discovery;

I will attempt to resolve, by agreement, my objections to matters contained in my opponent's pleadings and discovery requests;

In civil matters, I will stipulate to facts as to which there is no genuine dispute;

I will endeavor to be punctual in attending court hearings, conferences, meetings and depositions;

I will at all times be candid with the court and its personnel;

I will remember that, in addition to commitment to my client's cause, my responsibilities as a lawyer include a devotion to the public good;

I will endeavor to keep myself current in the areas in which I practice and when necessary, will associate with, or refer my client to, counsel knowledgeable in another field of practice;

I will be mindful of the fact that, as a member of a self-regulating profession, it is incumbent on me to report violations by fellow lawyers as required by the Rules of Professional Conduct;

I will be mindful of the need to protect the image of the legal profession in the eyes of the public and will be so guided when considering methods and content of advertising;

I will be mindful that the law is a learned profession and that among its desirable goals are devotion to public service, improvement of administration of justice, and the contribution of uncompensated time and civic influence on behalf of those persons who cannot afford adequate legal assistance;

I will endeavor to ensure that all persons, regardless of race, age, gender, disability, national origin, religion, sexual orientation, color, or creed receive fair and equal treatment under the law, and will always conduct myself in such a way as to promote equality and justice for all.

It is understood that nothing in these Principles shall be deemed to supersede, supplement or in any way amend the Rules of Professional Conduct, alter existing standards of conduct against which lawyer conduct might be judged or become a basis for the imposition of civil liability of any kind.

--Adopted by the Connecticut Bar Association House of Delegates on June 6, 1994

Faculty Biographies

<u>Jonathan A. Kaplan, Pullman & Comley LLC</u>

Jonathan A. Kaplan practices in the area of complex commercial litigation and handles a wide span of business disputes, including partner and shareholder disputes, business torts, and unfair trade practice claims. He regularly appears in state and federal courts. Jon has previously presented a Commercial Litigate Update at the CBA's Annual Meeting in 2016 and 2018. He has also presented on evidentiary issues including to the Connecticut Bar Association's ("CBA") Federal Practice Section on the Admissibility of E-Discovery and to the National Business Institute in a presentation entitled "How to Get Your Social Media, Email and Text Evidence Admitted (and Keep Theirs Out)."

<u>Kara S. Rescia, Rescia Law PC</u>

Kara S. Rescia is the principal of Rescia Law, P.C. with offices in Enfield, Connecticut and Northampton, Massachusetts, focusing on consumer and business bankruptcy and alternatives and small business representation. She is a 1988 graduate of the University of Southern Maine and a 1992 graduate of Western New England University School of Law. Since 1992, Attorney Rescia has concentrated her practice in bankruptcy, representing both debtors and creditors in business and consumer cases, as well as business and corporate law, including commercial financing and litigation. She is admitted to the bars for the Commonwealth of Massachusetts and the State of Connecticut and the U.S. District Court for the Districts of Massachusetts and Connecticut. Since 2010 and currently Ms. Rescia is a Chapter 7 panel trustee for the U.S. Bankruptcy Court, District of Connecticut. She is on the Executive Committee of the Connecticut Bar Association Commercial Law and Bankruptcy Section, a past Chair of the Bankruptcy Section of the Hampden County Bar Associations and is a member of the Massachusetts and Connecticut Bar Associations, the American Bankruptcy Institute, and the International Women's Insolvency Reorganization Confederation, New England and Connecticut Networks. She has been on the faculty of many seminars and has participated in numerous continuing legal education programs in the area of bankruptcy law.

Attorney Rescia is grateful for the contributions of Paige M. Vaillancourt, an associate at Rescia Law, P.C. She is a 2018 graduate of Western New England University School of Law and is part of the firm's bankruptcy and insolvency practice.

<u>Thomas J. Sansone, Carmody Torrance Sandak & Hennessey LLP</u>

Thomas J. Sansone is a partner in Carmody Torrance Sandak & Hennessey, where he has practiced in the civil litigation arena in Connecticut for more than 33 years, representing individuals and companies in a wide variety of business-related and personal disputes. He practices in various fields, including commercial, construction, and insolvency litigation. He has tried more than 90 cases to conclusion in Connecticut Superior Court, the United States District Court and the United States Bankruptcy Court, and has argued before both the Connecticut Supreme and Appellate Courts. Much of his trial work involves complex banking issues, including lender liability cases, contested foreclosure/collection matters, and representation of creditors in adversary bankruptcy proceedings.

From 2012 – 2018, Tom served as one of the 14 lawyers appointed by the judges of the Superior Court as a member of the Statewide Grievance Committee. During that time, he presided over dozens of hearings involving allegations of attorneys' professional misconduct.

Tom has also served the bar for many years as a member of the Executive Committee of the Commercial Law & Bankruptcy Section of the Connecticut Bar Association. From 2014 – 2016, he acted as the Secretary/Treasurer of that Section, and from 2016 – 2018, served as its Vice-Chair. On July 1, 2018, he assumed the chairmanship of the Section.

Tom is a published author, having twice written the annual review of commercial litigation cases for *The Connecticut Bar Journal* (2009, 2010), as well as co-authoring the Thomson Reuters book, *Inside the Minds: Banking & Finance Litigation Strategies* (2009). Tom is a frequent lecturer on commercial law topics and has, on three occasions, co-presented the annual update of Commercial Law & Bankruptcy at the Connecticut Bar Association's annual Connecticut Legal Conference.

Tom obtained both his undergraduate and law degrees from Boston University. He is active in a number of civic and community organizations including Clifford W. Beers Guidance Clinic, where he serves as president of its board of directors, the United Way of Greater New Haven (past Chair) and Vice-President of WIKS-USA, a charitable organization that supports a residential school in rural Western Kenya for children orphaned by the AIDS/HIV Pandemic.

Jeffrey M. Sklarz, Green & Sklarz LLC

Jeffrey M. Sklarz, is a founding member of Green & Sklarz LLC. Jeff's practice is focused on representing businesses and individuals with complex financial litigation needs including: bankruptcy/bankruptcy litigation, creditor/debtor litigation, tax litigation, pension, and employee benefit litigation and commercial litigation. He regularly tries cases and appeals before Connecticut's state and federal courts. Jeff has particular experience regarding the interplay between and bankruptcy and tax law.

Jeff received his B.A. in government from Colby College, his J.D. from the University of Connecticut, School of Law and his LL.M. (Taxation) from Boston University, Graduate Tax Program.

Jeff is a frequent writer and lecturer on topics involving bankruptcy, tax litigation and commercial litigation. In his spare time, Jeff enjoys swimming, biking, and running.

Awards and Recognitions

- Fellow of the American Bar Association (elected 2017)
- Fellow of the American College of Tax Counsel (elected 2016)
- Kathryn R. Heidt Memorial Award (2015). Conferred by the Business Bankruptcy Committee, of the American Bar Association, Business Law Section
- Connecticut Law Tribune's New Leaders of the Law Award (2005, Overall Achievement, Fairfield County)
- New England Super Lawyer® (Business Litigation) (2010 to present)
- Fellow of the American Bar Association, Business Law Section (2011 – 2013)

Current Leadership Positions

- Vice President, Greater New Haven Jewish Community Center
- Vice Chair, Bankruptcy Court Structure & Insolvency Process Committee, American Bar Association, Business Law Section
- Chair, Government Powers Subcommittee, American Bar Association, Business Law Section, Business Bankruptcy Committee
- Member, Executive Committee,, Commercial Law & Bankruptcy Section, Connecticut Bar Association

Commercial Law and Bankruptcy: Year in Review (CLC-D02)

Agenda

3:30 p.m. – 3:35 p.m.	Welcome and Introductions
3:35 p.m. – 4:10 p.m.	Commercial Litigation Speaker: **Jonathan A. Kaplan**, Pullman & Comley LLC
4:10 p.m. – 4:45 p.m.	Consumer Bankruptcies Speaker: **Kara S. Rescia**, Rescia Law PC
4:45 p.m. – 5:20 p.m.	Business Bankruptcies Speaker: **Jeffrey M. Sklarz**, Green & Sklarz LLC
5:20 p.m. – 5:30 p.m.	Q & A

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Annual Commercial Law Update

CBA Annual Conference
Commercial Law
and Bankruptcy Section

Jonathan Kaplan

June 10, 2019

Auction: Highest and Best Offers

- Restaurant Supply, LLC v. Giardi Limited Partnership, 330 Conn. 642 (2019)
- Commercial property owner sought to sell property, asked for "highest and best offers." PLTF had highest bid but owner chose to sell to DFDT. PLTF brought suit to compel specific performance and Trial Court struck complaint as allegations of complaint did not satisfy Statute of Frauds (CGS 52-550) as there was no purchase agreement.
- PLTF claimed a request for "highest and best" offers amounts to an exception to the Statute of Frauds under CGS 42a-2-328(3) – auctions for goods with reserve.
  - (3) Such a sale is with reserve unless the goods are in explicit terms put up without reserve… **In an auction without reserve, after the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time.**
- PLTF essentially claims that its offer was not merely an offer, but since it was the highest and best, it was an acceptance of owner's offer, and thus a binding contract
- UCC clearly only applies to goods, but PLTF claimed other states have applied section to real estate.
- Supreme Court affirmed Trial Court's decision.
  - Request for "highest and best offers" does not constitute an announcement in "explicit terms" that the property is offered "without reserve," or otherwise create an advance commitment to be bound by any such offer.
  - Did not decide whether 42a-2-328(3) applies to real estate transaction

Standing to Enforce Guaranty & Calculation of Debt

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- Jenzack Partners, LLC v. Stoneridge Associates, LLC, 183 Conn. App. 128 (2018)
- Sovereign Bank offered construction financing to Stoneridge, with guaranty by JT and mortgage on JT's residence securing the guaranty
- Sovereign assigned note to PLTF via allonge, but did not formally assign the guaranty
- **Holding: Assignment of note included assignment of secondary obligations including the guaranty**
- Court referred to Restatement (Third) of Suretyship and Guaranty: "The Restatement (Third) of Suretyship and Guaranty § 13 sets forth the rule that **when an obligee assigns its rights under an obligation, that assignment operates as an assignment of any secondary obligations attached to the primary obligation**."
- § 13, comment (f) "A secondary obligation, like a security interest, has value only as an adjunct to an underlying obligation. It can usually be assumed that a person assigning an underlying obligation intends to assign along with it any secondary obligation supporting it. Thus, **unless there is an agreement to the contrary or assignment is prohibited pursuant to subsection (1), assignment of the underlying obligation also assigns the secondary obligation**."
- Supported by Lemmon v. Strong, 59 Conn. 448 (1890)
- No bright line rule, but Court looked at entire circumstances of transaction to determine if Sovereign intended to assign the note and reserve the guaranty: If Sovereign Bank intended to reserve the guaranty for itself, it could have done so in the allonge

Jenzack Partners, LLC v. Stoneridge Associates, LLC, 183 Conn. App. 128 (2018)

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- Jenzack's Second Issue: Court's calculation of debt relied on PLTF's testimony detailing pre-assignment balance, which relied on document prepared by Sovereign Bank
  – Trial court admitted document prepared Sovereign that it prepared at time of transfer of note, which stated amount of debt at that time
- PLTF's witness had no personal knowledge of the pre-assignment balance or records, just what Sovereign detailed in document
  – Does not appear that PLTF had offered any other documentation to support the debt owed to Sovereign at time of transfer
  – Appellate Court held that there was no evidence of Sovereign's business records or duty to report an accurate starting balance to PLTF
  – Starting balance not calculated by PLTF, and thus not 'made in the ordinary course of business'
- Court reversed judgment of strict foreclosure and remanded

Affidavit of Debt

- Greenwich Portfolio Lender, LLC v. 111 Mill Street, LLC, 2018 WL 3965240 (Aug. 6, 2018, Adams, T.)
- 2014 Note and mortgage between FCG and DFDTs, with 2016 maturity date.
- In 2017, PLTF acquired note and mortgage from FCG and sought to foreclose against DFDTs
- DFDTs challenged affidavit of PLTF's principal claiming attached exhibits are not admissible business records. Court disagreed. PLTF also produced affidavit from FCG employee who was personally involved in the original note and mortgage transaction.
- Court made note of recent Appellate decision, Jenzack Partners, LLC v. Stoneridge Associates, LLC, 183 Conn.App. 128 (2018), which held that a business record received in the ordinary course of business rather than made in the ordinary course of business is not entitled to the hearsay exception under § 52-180(a).
- Court noted that New England Savings Bank v. Bedford Realty Corp., 246 Conn. 594, 603 (1998) provides that "[there] is no requirement in § 52-180 ... that the documents must be prepared by the organization itself to be admissible as that organization's business records."
- "There may be some disconnect between New England Savings Bank and Jenzack, but if so it need not be resolved here, because, as shown infra, [FCG's employee] was involved in the actual making of the Note and Mortgage."

Trade Names/Standing

- Omicron USA, LLC v. Infinity Group, 2018 WL 3026992 (May 24, 2018, Shapiro, R.)
  - Complaint filed against Defendant Infinity Group. Real corporate name is Infinity Office Interiors, LLC, using Infinity Group as a trade name
  - Court dismissed for lack of subject matter jurisdiction; trade name is not a legal entity, and thus can't be sued.
- Law Offices of John Q. Gale, LLC v. Nix's Kitchen, LLC, Docket No. HHD-CV-17-6084460-S (Oct. 30, 2018, Shapiro, R.)
  - Complaint filed by Plaintiff Law Offices of John Q. Gale, LLC, which is actually the trade name for John Q. Gale, LLC.
  - Court dismissed for lack of subject matter jurisdiction, and wouldn't allow for amendment under Conn Gen Stat 52-123 for circumstantial error. Amendment allowed for misnaming defendant, but not for misnaming plaintiff since a fictitious name plaintiff never had an existence and court never had jurisdiction.

Trade Names/Standing

- U.S. Bank, N.A. v. Armijo, 2018 WL 3446189 (Jun. 21, 2018, Lee, C.)
- US Bank acquired note and mortgage made in favor of MERS as nominee for Coldwell Bank Mortgage care of "PHH Mortgage Coldwell" ("Coldwell"). Coldwell was its doing business as name.
- DFDTs challenged standing of US Bank to bring
- Citations to American Wholesale Lender v. Pagano, 87 Conn. App. 474 (2005) were not relevant, as those cases involve litigation commenced by trade name
- "Contracts entered into with a fictitious or trade name, even if not properly registered as a D/B/A, as required by General Statutes section 35-1, are nevertheless valid"
- Use of Coldwell trade name did not invalidate note and mortgage, US Bank had standing to foreclose.

Trade Names/Standing

- Klewin v. Highland Hills Apartment, LLC, 2018 WL 2749625 (May 22, 2018, Calmar, H.)
- ACME Construction Specialties, Inc. ("ACME") brought lawsuit against DFDT's concerning a construction contract
  - Contract executed by Klewin Residential, which is the doing business as name for ACME
- Court found that ACME lacked standing because it was not a party to the contract
- Further, court found that ACME's existence was never disclosed during contract negotiation and formation process, and that trade name certificate was not filed until after execution of the contract

Lack of Certificate of Authority to Transact Business

- Midland Funding, LLC v. Hellman, 2018 WL 3401707 (June 19, 2018, Adams, T.)
- Plaintiff filed lawsuit to collect credit card debt
- Motion to dismiss filed because plaintiff did not have certificate of authority to transact business within the state. See Conn. Gen. Stat. 33-920, et seq.
- Conn. Gen. Stat. 33-920(b) provides that "securing or collecting debts" does not constitute transacting business within the state
- Court also noted that motion to dismiss is improper procedural vehicle since lack of certificate of authority does not deprive the court of subject matter jurisdiction
  - Rather, it is a special defense that must be pled and proved at trial; otherwise it is waived by defendant

Post-Judgment Enforcement – Sanctions

- Welsh v. Martinez, 2019 WL 1503934 (Feb. 27, 2019, Schulman, J.)
- PLTF won $2+ million judgment against DFDT for installation of electronic surveillance equipment in PLTF's home and vehicle
- Court imposed standstill orders and asset disclosure orders
- PLTF previously moved for contempt and court held DFDT in contempt (i.e. deposited wages into then-wife's bank account) and imposed fine of $2.2 million, payable directly to the plaintiff in the amount of $25,000 per month. Court noted that DFDT, a heart surgeon, had sufficient income/assets to pay the monthly amount.
- DFDT sought to stay the contempt order because he lost his job
- Issue: Whether court could consider value of otherwise exempt retirement account to determine DFDT's ability to pay sanctions?
- Court noted the issue is whether DFDT has ability to continue complying with previously imposed sanctions
  - Issue is not whether the assets are exempt from collection (See CGS 52-350f)
- Issue of first impression in CT. Other states "are in agreement that a court can consider otherwise exempt assets in determining ability to pay for purposes of contempt"
- Any balancing to hardship to DFDT (including tax issues on liquidating retirement account) outweighed by jury's finding that DFDT committed serious invasion of the plaintiff's privacy, DFDT failed to pay any substantial portion of judgment over 6 years and court's interest in insuring compliance with its orders (asset standstill and asset disclosure orders).

Post-judgment collection: Severance Payments

- Klauder v. Nickerson, 2018 WL 5307845 (Oct. 5, 2018, Tierney, K.)
- Issue: Whether periodic lump sum severance payments are earnings subject to exemption from garnishment?
- PLTF obtained foreign judgment against DFDT and domesticated judgment in CT. PLTF obtained property execution against Creditor of PLTF, who were parties to a severance agreement. DFDT claimed this was exempt as “Earnings” under CGS 52-350(a)(5):
  - “Earnings means any debt accruing by reason of personal services, including any compensation payable by an employer to an employee for such personal services, whether denominated as wages, salary, commission, bonus or otherwise.”
  - Earnings subject to maximum 25% wage execution
- Court reviewed severance agreement and determined that it was not “earnings,” and thus denied the exemption.

Post Judgment Interest

- Sikorsky Fin. Credit Union, Inc. v. Pineda, 182 Conn. App. 802, 804 (2018)
- After Sikorsky Financial Credit Union, Inc. v. Butts, 315 Conn. 433 (2015), "the trial court is mandated to enter postmaturity postjudgment interest, unless the parties expressly disclaim its accrual after maturity."
- If no interest rate specified, it accrues at the statutory rate of 8 percent.
- Here, the parties did not disclaim the accrual of interest eo nomine after maturity. Rather, the loan agreement provided that the defendant would pay interest at 15.99 percent until the debt was satisfied, and the addendum, the transaction receipt, and the plaintiff's affidavit of debt all show a contractual interest rate of 15.99 percent.
- The court, thus, was required, upon entry of judgment, to award postjudgment interest at that rate, which arose by agreement of the parties

Enforcing Foreign Judgments

- LVNV Funding, LLC v. Figueroa, 2018 WL 3203886 (Jun 7, 2018, Harmon)
- PLTF sought to enforce foreign judgment in Connecticut
- PLTF moved for summary judgment
- DFDT has burden of establishing lack of personal jurisdiction over it at trial
- HOWEVER, at summary judgment stage, PLTF has burden of establishing prima facie case that the foreign court properly exercised personal jurisdiction over DFDT before DFDT needs to come forward with evidence to rebut
  - Complaint failed to include any information describing how foreign action had personal jurisdiction (i.e. Complaint failed to state was resident of the foreign state, failed to state how DFDT served since DFDT failed to appear)

Enforcing Foreign Judgment

- Despotovic v. Gavrilovic Holding Petrinja, 2018 WL 6016710 (Oct. 29, 2018, Shapiro, R.)
- CGS 50a-32: the Uniform Enforcement of Foreign Judgments Act applies to "any foreign judgment that is **final** and **conclusive** and **enforceable** where rendered."
- Court found that there was no evidence to demonstrate that Croatian money judgment was final, binding and enforceable
- Cited to Panchenkova v. Chigirinsky, 2015 WL 4098153, (June 5, 2015, Dooley, J.), where parties presented expert opinions concerning Russian law, including the plaintiff's expert's opinion, which the court credited, that the judgment there was final, binding and enforceable in Russia under Russian law.

Long-Arm Jurisdiction

- North Sails Group, LLC v. Boards & More, GMBH, 2018 WL 3015199 (May 23, 2018, Moukawsher)
- CT PLTF sues Austrian DFDT for breach of a license agreement. Agreement required DFDT to place PLTF's logo on product; DFDT started putting its own logo on product. DFDT moved to dismiss for lack of personal jurisdiction.
- Conn's long-arm statute, CGS 52-59b, is subject to the U.S. Supreme Court's ruling in Bristol-Myers Squibb Co. v. Superior Court of California, 137 S. Ct. 1773 (2017).
  - In order for a court to exercise specific jurisdiction over a claim, there must be an "affiliation between the forum and the underlying controversy, principally, [an] activity or an occurrence that takes place in the forum State." When there is no such connection, specific jurisdiction is lacking regardless of the extent of a defendant's unconnected activities in the State.
  - Focus on where the activity giving rise to the lawsuit happened and where it caused injury.
- PLTF was harmed in CT and DFDT had multiple contacts with CT.
- BUT DFDT's relevant conduct (in violating the license agreement by placing its own logo on the product) took place elsewhere. Court dismissed the case.

Enforcement of Lost Note

- Seven Oaks Enterprises, L.P. v. Devito, 185 Conn. App. 534 (2018)
- SOE and SOM sue Devito for breach of note. Trial court judgment for $1.325 million. Devito appealed.
- SOE sold an LLC to Devito in exchange for cash and the note.
- SOE assigned all claims related to sale of LLC to SOM.
- First issue: Did this include the claims under the note?
  - Court reviewed note and assignment, indicated that the assignment did not contain any retention by SOE, and found assignment included the claims under the note
- Second issue: Did SOM have right to enforce lost note?
  - the assignee of a promissory note that had already been lost by the assignor lacked standing to enforce the note
  - C.G.S. §42a-3-309 provides in relevant part that "A person not in possession of an instrument is entitled to enforce the instrument if (i) the person was in possession of the instrument and entitled to enforce it when loss of possession occurred…"
  - Distinguished New England Savings Bank v. Bedford Realty Corp, 238 Conn. 745 (1996) (allowed assignee of already-lost note to enforce because it chose equitable action of foreclosure)
  - CT has not adopted revision to Model UCC 3-309, which would provide standing to SOM

Statute of Limitations: Action for an Account

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- Ajluni v. Chainani, 184 Conn.App. 650 (2018)
- General Statutes § 52-576 (a) provides: “No action for an account, or on any simple or implied contract, or on any contract in writing, shall be brought but within six years after the right of action accrues, except as provided in subsection (b) of this section.”
- S.O.L. “can be lost by an unequivocal acknowledgment of the debt, such as a new promise, an unqualified recognition of the debt, or a payment on account.... “
- DFDT’s emails to PLTF provided as possible
  - “[I]t is my full intention to get you paid as soon as possible
  - “it is my endeavor and intent to at least get you your principal back as soon as I possibly can.”
  - “Even though you are foreclosed out, it is fully our intention to at least get you your full principal back as soon as possible.”
- PLTF emailed DFDT concerning debt, and DFDT never disputed
- DFDT reaffirmed the existence of the debt, tolling the statute of limitations
  - DFDT did not dispute the existence of the debt; only the if and when he would pay it

Factoring/ Assignment of Account

- Factor King, LLC v. Housing Authority for City of Meriden, 2018 WL 6016838 (Oct. 29, 2018, McNamara, K.)
- AEG entered into factoring agreement with PLTF, who notified DFDT that AEG assigned to PLTF "all of its present and future accounts receivables."
- 2 months later, DFDT paid AEG $2 million, and PLTF sued DFDT for account stated
- Under Article 9, when an account debtor receives notice that an amount due on an account has been assigned and that payment is to be made to the assignee, it cannot pay the assignor to discharge the debt. See CGS 42a-9-406(a). If the account debtor pays the assignor, it remains liable to the assignee for the same amount.
- No evidence that the amount the defendant paid to AEG was on invoices that it had actually purchased from AEG pursuant to the factoring agreement.
  - Factoring agreement was actually an option to purchase accounts receivable
  - Without exercising its option to purchase an invoice offered for sale by AEG, there would be no transfer of the legal right to receive payment on those invoices.
  - Notice of assignment to DFDT not sufficient
- PLTF claimed it had security interest in the accounts receivables; Court held this did not render it an assignee entitled to payment

Agency/Fiduciary Relationship

- Jolen, Inc. v. Brodie and Stone, PLC, 186 Conn.App. 516 (2018).
- PLTF sued DFDT for breaching product distribution agreement between manufacturer and exclusive distributor.
- Issue: Whether DFDT owed a fiduciary duty to the PLTF?
- Trial court found that DFDT was PLTF's **agent** for distribution of PLTF's product.
- But then noted that "a contractual duty to act as [a] distributor of a manufacturer's product does not necessarily impose fiduciary duties on a distributor to the manufacturer."
- Found that relationship was not a fiduciary one.
- Appellate Court reversed. **Agents are per se fiduciaries**. Since trial court concluded that "the distribution agreement established as a matter of law the existence of a principal-agent relationship between the parties" (which was not challenged on appeal), DFDT had been PLTF's fiduciary.

Foreclosure: Condition Precedent - Notice of Default/EMAP

- Aurora Loan Services, LLC v. Condron, 181 Conn. App. 248 (2018)
- PLTF failed to comply with notice requirements for default letter
  - Loan documents obligated PLTF to send pre-acceleration notice of default to borrower
  - Loan documents stated notices shall be deemed given when "mailed by first class mail or when actually delivered to Borrower's notice address if sent by other means"
  - PLTF sent default letter and EMAP letter via certified mail
  - No evidence offered from either party showing failure to deliver either letter
  - BUT, no evidence showing return receipt confirming delivery
- Court held that the notice of default was a condition precedent to a foreclosure
  - Court reviewed the delivery clause to determine what the parties' intended
    - Noted difference between first class mail and certified mail
    - Noted certified mail requires actual proof of delivery
    - Since PLTF failed to introduce any proof of delivery, PLTF failed to satisfy condition precedent
- Substantial compliance rule did not apply – only applies to nonessential conditions
  - Cases relied on by PLTF dealt with content of notice of default, not method of delivery
- EMAP letter sent via certified mail was sufficient; statute did not specify and there was no contract requiring the means of delivery in one method versus another

Foreclosure: Subject Matter Jurisdiction - EMAP Notice

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- M & T Bank v. Wolterstorff, 2018 WL 4655926 (Sep. 10, 2018, Genuario)
- PLTF mailed EMAP notice to 55 Old Stone Bridge Road
- Actual address of mortgage premises:55 **North** Old Stone Bridge Road
- Tracking history showed that letter not delivered and returned to sender
- First, Court held that the following provision in CGS 8-265ee, Emergency Mortgage Assistance Program, is jurisdictional
  - "no such mortgagee may commence a foreclosure of a mortgage prior to mailing such notice"
  - Refers to *People's United Bank v. Wright,* Superior Court for the judicial district of Stamford/Norwalk at Stamford, Docket Number CV106004126-S (Mottolese, J.T.R., March 30, 2015) [60 Conn. L. Rptr. 69]
- Second, it granted motion to dismiss finding that PLTF failed to comply with this requirement

Foreclosure: Special Defenses - HUD Regulations/Mediation

- Wells Fargo Bank, N.A. v. Lorson, 183 Conn. App. 200 (2018)
- Appeal of judgment of foreclosure in PLTF's favor
- DFDT argued that Bank has obligation to demonstrate compliance with HUD regulations
  - Court held that failure to comply with HUD obligation needs to be raised as a special defense, and DFDT failed to raise this as special defense
  - Courts outside of Connecticut have adopted similar ruling
  - Supreme Court granted cert on this issue; currently pending
- DFDT also argued that as part of foreclosure mediation program, Bank made misrepresentations as to DFDT's ability to obtain permanent loan modification. Parties entered into special forbearance agreement with 3 months of reduced payments
  - Documents referenced "investor approval is still pending" as well as clause expressly stating that Bank had "no obligation to enter into any further agreement"
  - Bank requested additional information from DFDT on subsequent judgment lien on property (or for DFDT to remove lien), but DFDT failed to respond
  - DFDT's defenses related to mediation were without merit

Foreclosure: Special Defenses - Unclean Hands

- Wahba v. JP Morgan Chase Bank, N.A., 2018 WL 3518577 (Jun. 28, 2018, Povodator, J.)
- Jury already founds for Bank as to PLTF's CUTPA claim; remaining issue was DFDT's foreclosure counterclaim and in particular, PLTF's special defenses
- Borrower claims that prior to foreclosure, she had issue making monthly payments and that Bank told her to miss 3 payments so that Bank would be able to enter into agreement to reduce her monthly payments, and that when she ultimately entered into loan mod, payments were not sufficiently lowered.
  - Court noted that Borrowers appeared to want to take advantage of programs for distressed borrowers, but Borrowers did not qualify as they had high income and otherwise not in financial distress
- Court notes that these facts are slightly different than US Bank v. Blowers, 177 Conn. App. 622 (2018) (act during loan mod. discussions is not a special defense, but breach of loan modification may be)
  - The acts in Blowers were more extreme (banks offers were withdrawn)

Foreclosure: Special Defenses/ Counterclaims – MVE/Transaction Test

- Spectrum Stamford, LLC v. 400 Atlantic Title, LLC, 2018 WL 5797819 (Oct. 18, 2018, Genuario)
- Court struck First Counterclaim alleging breach of implied covenant of good faith and fair dealing – term sheet expressly stated that it was not binding, thus no obligation to enter into loan modification
- Court did not strike Second Counterclaim alleging tortious interference with business expectancy. PLTF's predecessor, instead of negotiating with borrower, approached borrower's largest tenant who was about to engage in lease renewal negotiations with borrower. Predecessor convinced tenant to purchase the note/mortgage.
  - Court found that borrower alleged sufficient facts to survive motion to strike.
- PLTF also sought to strike asserting claim not related to making, validity or enforcement (MVE) of note/mortgage.
  - Citi Mortgage, Inc. v. Rey, 150 Conn.App. 595 (2014): counterclaim need not be directly related to MVE of mortgage note, but must have "sufficient relationship" to MVE of the note mortgage to satisfy Practice Book 10-10's transaction test
- Court noted the DFDT's counterclaim were more distant that in Rey case, but since foreclosure is equitable, and allegations "directly impact[ed] the ability of the defendant to enter into a lease agreement with its major tenant which in turn impacted the willingness of the plaintiff's predecessor to negotiate a loan modification agreement."
- Court also noted that alleged malfeasance was directly related to events that led PLTF to becoming holder of note and assignee of mortgage.
- Held that counterclaim sufficient intertwined to survive motion to strike

Foreclosure: Special Defenses - Unclean Hands/HAMP & MVE Test

PULLMAN & COMLEY 100 YEARS

- U.S. Bank National Association v. Eichten, 184 Conn. App. 727 (2018)
- Appellate Court overruled Trial Court's granting of summary judgment in PLTF's favor, as genuine issue of material fact existed as to whether mortgagee's delay in denying the federal Home Affordable Modification Program (HAMP) modification for mortgagor's loan violated unclean hands doctrine.
- DFDT entered into Trial Payment Plan (TPP) of 3 payments and claims he was promised permanent modification. PLTF claims DFDT failed housing expense to income ration and denied permanent modification
- Appellate Court found that "This special defense questions the legitimacy of the plaintiff's processing of the defendant's application for a loan modification. It raises a question as to why the plaintiff failed to send the defendant a permanent loan modification agreement if she was approved for a loan modification in March, 2011.
  - In opposing summary judgment, DFDT produced PLTF's internal documents that showed at certain points during discussions with PLTF, DFDT met the housing ratio and PLTF's internal notes showed an action item to prepare the modification documents. DFDT also produced evidence of HAMP guidelines, which requires servicer/lenders to make determination of eligibility before the end of TPP, but no evidence that PLTF did that here.
  - Court focused on length of time to deny DFDT a permanent modification (20 months) and on whether PLTF treated DFDT in a fair, equitable and honest manner
- Appellate Court then held that genuine issues of material fact existed to prevent it from determining whether the special defense was "invalid because it does not relate to the making, validity, or enforcement of the note and mortgage."
  - Cited to U.S. Bank National Assn. v. Blowers, 177 Conn. App. 622 (2018), which found that its alleged improper conduct occurring during mediation and modification negotiations lacked "a reasonable nexus to the making, validity, or enforcement of the note or mortgage." Blowers noted, however, that if "the modification negotiations ultimately result in a final, binding, loan modification, and the mortgagee subsequently breaches the terms of that new modification, then any special defenses asserted by the mortgagor in regard to that breach would relate to the enforcement of the mortgage.
  - Noted that unclean hands does not need to relate to the making, validity or enforcement ("MVE") of the note citing *Thompson v. Orcutt*, 257 Conn. 301 (2001).

Foreclosure: Deficiency Judgment - Appraisal

- Webster Bank, N.A. v. Frasca, 183 Conn. App. 249 (2018)
- Following foreclosure of property, Bank moved for deficiency judgment and trial court judge (Tierney, K.) denied finding that Bank's appraisal report was not credible
- Bank's appraisal report contained 3 valuation methods (sales comparison $725k, cost approach $846k, and the property field card $894k) and concluded at $725k
  - DFDT did not provide its own appraisal but offered testimony challenging Bank's appraisal, noting significant errors (wrong sq. ft.), omission of comparable antique homes, improperly included a short sale comparison, and comparisons were all Stamford addresses (this property was in Stamford but has a Greenwich address)
  - Trial court deemed appraisal report unreliable and lacking credibility, affirmed by Appellate Court
- Judicial bias not found: Trial Court's comments regarding Bank's ability to collect on a deficiency (including seeking recourse from DFDT's wealthy father-in-law) were improper, but not judicial bias

Foreclosure-Summary Judgment

- Christiana Trust, a Division of Wilmington Savings Fund Society, FSB v Lewis, 184 Conn. App. 659 (2018)
- Trial court granted motion for summary judgment in foreclosure matter; Appellate Court overturned.
- In his affidavit, the defendant stated that he “reviewed the mortgage attached to the plaintiff's memorandum of law,” and “[t]he signature that appears on that mortgage is not mine; I did not sign it.”
- Appellate Court held that this was sufficient to question the validity of the mortgage and gave rise to a genuine issue of material fact as to the authenticity of the signature on the mortgage.
- Admissions concerning mortgage during separate bankruptcy proceeding were evidentiary admissions, not judicial admissions (because they were not made in present proceeding)

Foreclosure: Enforceability of Settlement Agreement

PULLMAN & COMLEY 100 YEARS

- Capitalsource Finance, LLC v. Hartford Downtown Revival, LLC, 2018 WL 3965071 (Jul. 27, 2018, Cobb, J.)
- Parties mediated commercial foreclosure case and other cases involving the parties
- Parties reported agreement that included provision for strict foreclosure with law days starting in July 2018 and vacate date of July 15, 2018 by occupants. Debt figures to be subsequently established.
  - DFDT's principal canvassed on the record
- DFDT reneged and PLTF sought to enforce agreement via *Audubon* hearing
- Court found that the **debt figure was a necessary element** to a judgment; could not be severed. Thus, the agreement was not enforceable

Foreclosure: SBA Loan/ Deficiency Judgment

- Antonucci v. Small Business Administration, 2018 WL 4697282 (D. Conn. 2018, Shea, M.)
- HLIB gives $430k SBA loan to borrower and Antonucci guaranteed loan and gave mortgage on his residence
  - SBA guarantees 75% of the value of the loan
- After default, HLIB forecloses on mortgage and obtained title to property. Conveyed to third party for $275k.
- SBA's records show net proceeds of $223k, and Treasury Department sought to garnish Antonucci's wages for remainder.
- Antonucci challenged and SBA hearing officer agreed with Treasury; appeal to District Court ensued. Reviewed under Administrative Procedures Act and arbitrary and capricious standard
- (1) Failure to obtain deficiency judgment against borrower did not preclude proceeding to enforce guaranty
- (2) Proper for SBA to reduce the debt by the net proceeds of the sale ($223k), as opposed to the fair market value of property ($350k)
  - Cited to FDIC v. Fonte, 48 Conn. 531 (1998) ("In calculating a deficiency judgment, a mortgagor is not entitled to a credit for the fair market value of the property sold, but, rather, is entitled to a credit for the amount of the sale proceeds"), which cited to CGS 49-28
- (3) SBA's 75% loan guaranty does not affect total debt owed by borrower or guarantor
- Not discussed by this decision but:
  - This case involved a strict foreclosure and deficiency procedure is specified in CGS 49-14, not CGS 49-28
  - CGS 49-28 applies a 50% penalty if sales price is below the appraisal, but did not apply it here

Foreclosure/Civil Theft

- LPP Mortgage, Ltd. v. Underwood Towers L.P., 2018 WL 3403760 (Jun. 25, 2018, Miller, G.)
- UTLP created to develop Park Place Towers in Hartford. UTLP obligated under two notes with HUD, which contained certain obligations and restrictions, including a requirement that "Net Cash" be paid to HUD and limited the ability of UTLP, and its property manager CDC, to take funds from the rental income
- Bank that acquired notes declared default for failure to pay, failure to provide information, and then filed 10-count suit
- Court entered judgment on counts alleging foreclosure, breach of loan documents, breach of covenant of good faith and fair dealing, unjust enrichment, conversion, and CUTPA
  - (1) Payments to UTLP's principal of $500k over 7 year period as 'part time general manager of project' were not authorized, and hidden from HUD/Bank
  - (2) Free apartment to Nicholas Carbone, Hartford power broker who helped get project off the ground, was not authorized and hidden from HUD/Bank
  - (3) Payments to CDC in excess of $8k per month cap were not authorized and hidden from HUD/Bank
  - (4) Use of ordinary income for capital projects, instead of using capital account, was done to reduce amount of Net Cash it had to pay HUD/Bank
  - (5) Payment of legal fees from operating income was not authorized
  - But, rent-free apartment and bonus to on-site manager of property was allowed
- Court ruled in Defendants favor on Civil Theft claim:
  - Difficult to find intent to steal by clear and convincing evidence
  - "If someone believes, however ridiculously, that he or she is entitled to money in the hands of another, something which he has a superior claim to, this simply is not the same thing as finding that a defendant knows that he or she is not entitled to someone else's property, but takes it anyway with the intent of permanently depriving the victim. This latter scenario demonstrates civil theft."

Special defense: Recoupment

- Norboe v. Wells Fargo Bank, N.A., 2018 WL 3714002 (Jul. 13, 2018, Moukawsher, J.)
- Norboe had note and mortgage with Bank
- Norboe filed for bankruptcy and received discharge of personal obligation for the debt to bank
- Bank subsequently sent agents to secure the property that was subject of the mortgage, despite Norboe still occupying premises.
- Norboe files suit and Bank files special defense of recoupment, seeking to offset any damages to the debt that was previously owed by Norboe under the note
- Setoff not available due to discharge
- “Recoupment is an offset that survives the discharge of a debt in bankruptcy but is confined to mutual claims arising from a single transaction.”
- Only allowed where “both debts ... Arise out of a single integrated transaction so that it would be inequitable for the debtor to enjoy the benefits of that transaction without also meeting its obligations.”
- Norboe’s claim did not arise out of same transaction as note/mortgage; his lawsuit was for property and personal injury
- Court dismissed recoupment special defense

CGS 52-212a, Motion to Open Judgment

PULLMAN & COMLEY 100 YEARS

- Stamford v. Rahman, 188 Conn.App. 1 (2019)
- PLTF filed foreclosure and named 3 banks as subsequent encumbrancers; WFB, BOA and JPM. Owner of property procured BOA mortgage by providing bank with copy of fraudulent, unrecorded Satisfaction of Mortgage purporting to release WFB's mortgage.
- WFB did not appear; foreclosure sale resulted in $350k deposited into court. BOA filed for supplemental judgment and court awarded $350k to BOA despite lower priority than WFB.
- 3 years later, WFB appeared and moved to open. WFB claimed 4 month time limit to open judgment (CGS 52-212a) did not apply since supplemental judgment obtained by fraud. Trial Court agreed (also relied on fact that BOA not served with notice of motion for supplemental judgment) and awarded proceeds to WFB.
- Appellate Court reversed:
- (1) Trial Court's decision that WFB acted with reasonable diligence to identify fraud and exercise rights was clearly erroneous. WFB knew of fraud some 9 years earlier; even obtained judgment against owner.
- (2) Fraud was committed by owner, not BOA. Thus, the exception to four month rule was inapplicable
- (3) No obligation to serve motion for supplemental judgment on non-appearing parties.

Attorney's Fees under Note/Mortgage

- Connecticut Community Bank, N.A. v. James Kiernan, Jr., 187 Conn. App. 868 (2019)
- PLTF commenced foreclosure against Kiernan; Wells Fargo Bank (WFB) challenged PLTF's priority asserting claim for equitable subrogation. Parties agreed to sell property and deposit into escrow account pending resolution of PLTF's dispute with WFB.
- PLTF amended complaint to interpleader and for action on note. After defaulting Kiernan, Court granted summary judgment on action for note and PLTF sought $100k attorney's fees, which included substantial attorney's fees in connection with priority dispute with WFB.
- Trial court only awarded $11k, and PLTF appealed.
- Despite broad language of attorney's fee provision in mortgage documents, no authority existed for the position that a mortgagee should be liable for post-foreclosure attorney's fees that were not directly tied to some act of mortgagee.
- Relying on Total Recycling, 308 Conn. 312 (2013), court held that only attorney's fees directly or closely related to foreclosure action against Kiernan may be awarded.
  - Priority dispute were not intertwined with liability under note
- In addition, Trial Court provided PLTF's attorney with opportunity to re-submit attorney's fees affidavit after admitting fees sought were excessive. Counsel said "I'm sure you're more than capable of reviewing what has been submitted and coming up with what you believe is a fair amount of time for the work . . . ." Appellate Court declined to review claim for error after PLTF failed to address opportunity to apportion fees between the two disputes

Attorney's Fees

- Wahba v. JP Morgan Chase Bank, N.A., 2018 WL 6721957 (Nov. 26, 2018, Povodator, J.)
- Follow-up to prior case: Does DFDT get attorney's fees for defending against PLTF's CUTPA claim?
- Cited to Total Recycling Services of Connecticut, Inc. v. Connecticut Oil Recycling Services, LLC, 308 Conn. 312 (2013) requires a party seeking attorney's fees to separate fees between claims entitled to attorney's fees, and those that aren't entitled; if claims are so intertwined, then party may be entitled to all fees associated with the intertwined claims.
- Court characterized PLTF's claim as preemptive litigation, which sued DFDT for CUTPA. DFDT then filed counterclaim of foreclosure. Judgment in DFDT's favor.
- Note contained provision obligating PLTF to pay all of DFDT's "costs and expense in enforcing [the] Note." Court focused on the "the intended scope of the phrase 'enforcing this note'". Court believed it to be a reasonable inference that the action was commenced by the plaintiff as a two-pronged preemptive measure, given that the loan was not current at the time the action was commenced, and in that context, everything is related to enforcement of the debt obligation."
- Court awarded attorney's fees

When IS Attorney's Fees Award Final for Purposes of Appeal

PULLMAN & COMLEY 100 YEARS

- Town of Ledyard v. WMS Gaming, Inc., 330 Conn. 75 (2018)
- Town sought to collect personal property taxes for slot machines on casino property. Tribal nation filed federal court action to determine if state/town could tax this property. 2nd Circuit agreed with State/town. Town and owner resolved all issues related to personal property taxes except for one issue: whether the Town could collect its attorney's fees for the federal court action under CGS 12-161a
- Superior Court granted summary judgment in favor of town, and before hearing on amount of attorney's fees, owner appealed.
- Appellate Court dismissed appeal finding lack of final judgment since amount of attorney's fees not determined
- Supreme Court reversed – judgment of liability for attorney's fees, with the amount to be determined, is a final judgment

When IS Attorney's Fees Award Final for Purposes of Appeal
Town of Ledyard v. WMS Gaming, Inc., cont'd

PULLMAN & COMLEY 100 YEARS

- Court relied on 1988 case, Paranteau v. DeVita, 208 Conn. 515 (1988), which adopted the federal court's bright line test:
  - "a [bright line] approach which obviates the need for individual case review through the implementation of a uniform rule stating that an unresolved issue of attorney's fees does not prevent judgment on the merits from being final and immediately appealable."
  - "a judgment on the merits is final for purposes of appeal even though the recoverability or amount of attorney's fees for the litigation remains to be determined."
- This rule applies even on harsh cases. See Benvenuto v. Mahajan, 245 Conn. 495 (1998) (judgment of strict foreclosure without attorney's fees determination is still a final judgment for appeal)
- Recently affirmed in Hylton v. Gunter, 313 Conn. 472 (2014), which "conclude[d] that an appealable final judgment existed when all that remained for [a] trial court to do was determine the amount of the attorney's fees comprising the common law punitive damages that it previously had awarded."
- Summary: FILE APPEAL WITHIN 20 DAYS OF JUDGMENT AS TO LIABILITY TO PRESERVE APPEAL RIGHTS

Equitable Subrogation

PULLMAN & COMLEY 100 YEARS

- J.P. Morgan Chase Bank, N.A. v. Montanaro, 2018 WL 1936656 (Mar. 26, 2018)
- Borrowers told lender they were title holders to property; lender loaned $300,000 and recorded mortgage, but borrowers were not the actual owners (it was owned by trusts in their names). Property sold to third party and lender eventually commenced foreclosure.
- Court struck court equitable subrogation count:
  - Doctrine "clearly limited to situations where the party invoking the benefit of the doctrine has paid a debt owed by another, and therefore gets to step into the shoes of the satisfied creditor"
  - No allegation that lender's funds used to pay off other creditor; no lien to step in the shoes of
- Court also struck equitable subordination count – limited exclusively to Bankruptcy Courts

Fraudulent Transfer

- Featherston v. Katchko & Son Construction Services, Inc., 2018 WL 3203876 (Jun. 11, 2018, Adams)
- Previously, PLTF gets judgment against Katchko & Son (Son), who then transfer all assets to Katchko & Son**s** (Sons). PLTF sues both entities for violations of CT fraudulent transfer act and CUTPA
- PLTF and former accountant of Son/Sons testified, and DFDTS moved for judgment of dismissal
- Court found PLTF's testimony to be credible: saw equipment of Son at job site during many visits, claimed he saw same equipment at Sons' headquarters (recognized unique writing on equipment).
- Evidence sufficient to survive motion for judgment of dismissal
  - Accountant testified that Son ceased and Sons created at time of original judgment, and all assets were transferred out of Son without any value to Son
- Subsequently, Court entered judgment in PLTF's favor, and awarded interest and attorney's fees (2018 WL 6304213, Nov. 8, 2018, Hernandez, A.)

Economic Loss Doctrine

PULLMAN & COMLEY 100 YEARS

- Connex Credit Union v. Barbarino Bros., Inc., 2018 WL 4038227 (Aug 1, 2018, Wilson)
- PLTF and DFDT were parties to dealer sales agreement, where PLTF would provide financing to DFDT's customers to purchase vehicles. DFDT's advised customers to breach financing with PLTF in order to put customers in newer vehicles, which resulted in loss to PLTF
- Parties entered into settlement agreement that terminated dealer sales agreement and DFDT represented it wouldn't recommend that customers breach financing agreements with PLTF. DFDT continued practice, and PLTF sued for variety of theories
- DFDT moved to strike claim of misrepresentation, negligent misrepresentation and negligent supervision under economic loss doctrine:
  - "The economic loss doctrine is a judicially created principle which prohibits recovery in tort when the basis for that tort claim arises from a violation of a contract and damages are limited to purely economic losses as opposed to personal injury or property damage."
- Alleged representations occurred prior to the contract formation (the settlement agreement) and thus are not barred by doctrine
- Negligent supervision claim was separate and independent from the breach of contract claims and thus not barred by the economic loss doctrine

Alter Ego/Interpleader Action

- Thomas Industries, Inc. v. City of Bristol, 336 F.Supp.3d 28 (2018)
- Weed owned two companies, BW and Chapman. BW delinquent to IRS, DOL and Bristol, who made assessments/issued liens against BW. , who made multiple assessments against BW.
- Weed contacted Thomas Industries to auction off some of BW's equipment, but on eve of auction, Weed said that 9 pieces of equipment belonged to Chapman.
- After auction, Thomas Industries filed interpleader action depositing proceeds into court.
- USA and auctioneer disputed claim; BW previously reported machines on its loan application, located at BW's place of business, and Weed sent email to Plaintiff claiming all property belonged to BW.
- Ownership was issue of fact, but, court held Chapman was alter ego of BW (analysis under both federal or state law)
  - (1) Chapman was physically located at the same address as BW, used the same phone number as BW, shared the same officers; (2) Chapman property intermingled with BW's property; (3) intermingled funds between companies; (4) Chapman did not file annual reports or file property tax returns for several years
- Except for those liens under 26 USC 6323 (not applicable here), priority under federal law is under first in time, first in right

Personal Guaranty

- Gen. Linen Serv., LLC v. Chirnomula, 2018 WL 3060193 (Jun. 4, 2018)
- Plaintiff provided linens to a group of restaurants in Fairfield County
- Plaintiff sought PJR against two individuals. First individual (a part owner) filed bankruptcy. Second individual was employee who signed Rental Services Agreement on behalf of restaurants, which contained personal guaranty language on back side.
- Both parties admit they didn't review back side prior to signing
- Court found that this was a contract of adhesion against employee personally, as he was not party to Retail Service Agreement and did not have bargaining power.
- Court held the contract was against public policy and void as to any effect on the employee

Prejudgment Remedies

- Viola v. Flanagan, 2018 WL 3431480 (Jun 14, 2018, Adams, T.)
- PLTF commenced application for prejudgment remedy, which Court granted.
- PLTF served DFDT with signed complaint and manuscripted summons.
- DFDT moved to dismiss because PLTF failed use pre-printed form, JD-CV-1, as it writ of summons
- Practice Book 8-1(c) expressly provides that a PLTF is not to use JD-CV-1 in any action in which attachment, garnishment or replevy is sought

Standing to Assert Claims Not Listed In Bankruptcy Schedules

- *Rider v. Rider,* 2018 WL 5796385, (Oct. 12, 2018, Cosgrove, J.)
- PLTF sued DFDT to quiet title claiming that PLTF owned a condo.
- PLTF failed to include condo or his claim against DFDT in his bankruptcy schedules.
- Court granted DFDT's motion to dismiss
  - Citing 11 USC 554 (property of the estate), Court noted that property not listed on schedules have not been abandoned by trustee
  - Claim belonged to trustee and thus PLTF lacked standing

Standing to Assert Claims Omitted from Bankruptcy Schedule

PULLMAN & COMLEY 100 YEARS

- Plant v. Hopper, 2018 WL 3431493 and 2018 WL 3479033, (Jun. 26, 2018, Tierney, K.)
- Hopper entered into agreement with the Perlmans to perform design and purchasing services on Perlmans' residence in Greenwich
- In 2010, O'Brien entered into agreement with Hopper to profit share on the venture
  - O'Brien later assigned claim to Plant
- In August 2010, O'Brien filed for bankruptcy and did not list claim against Hopper, nor did she list contract with Hopper on her schedules
- Court did not dismiss case, nor did it grant summary judgment to Hopper
- Question of fact remained as to whether services were performed before or after filing date
  - Any services performed before would mean judgment for defendant

Automatic Stay in CT Courts

- Mulshine v. Mulshine, 2018 WL 6982657 (Dec. 3., 2018, Heller, J.)
- Family Court held hearings on various post-judgment motions, which under consideration by the Court, when husband filed for chapter 13 relief
- 11 USC 362(b)(2)(A)(ii) – does not stay actions for alimony, maintenance or support, or for collection of those items from property that is not property of the estate.
- If brought under Chapter 7, the Court could conceivably rule on the motions. Court cited Brown v. Brown,, Superior Court, judicial district of New Haven, Docket No. FA-07-4028466-S (Dec. 30, 2009, Conway, J.), which found that 11 USC 362(b)(2)(A)(ii) permitted it to adjudicate contempt motion, but it needed to be cautious since
  - "[A] state court makes such a decision at its peril, for the bankruptcy court is not precluded by the state court's decision. If the bankruptcy court later decides that the state court was incorrect, the state court proceedings in violation of the stay are void ... On the other hand, if the state court is correct in deciding that the stay does not apply, the state court proceedings are not void." (Citations omitted.)
- In Chapter 13, where post-petition income becomes property of the estate (11 USC 1306), the case is stayed and wife needed to obtain relief from stay (or dismissal) before Family Court could adjudicate the motions.
  - Unlikely that chapter 13 debtor had any property outside of property of the estate
  - Therefore, 11 USC 362(b)(2) likely has little to no application in Chapter 13

The Obvious Category

- HSBC Bank USA, N.A. v. Hallums, 183 Conn. App. 175 (2018)
  - Court rejected defendant's argument that a bankruptcy discharge precluded Court from entering judgment of foreclosure on premises
    - It precludes personal liability, but not in rem
- Citigroup Mortgage Loan Trust, Inc. v. Kirby, 2018 WL 2460318 (May 11, 2018, Truglia, A.)
  - Court rejected defendant's argument that her interest in property can't be foreclosed because she only signed mortgage, but did not sign note
  - "The defendant has not provided, and the court is not aware of any case law in Connecticut which holds that one who joins in the execution of a mortgage as security of the note may defeat a foreclosure action merely because he or she did not sign the note"
- Webster Bank, N.A. v. Colello, 2018 WL 3203881 (Jun. 11, 2018, Harmon)
  - Co-borrower under home equity line of credit remained liable to bank despite the other co-borrower, who used the funds, walked away from the home and was unavailable to re-pay bank

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COMMERCIAL LAW & BANKRUPTCY

THE YEAR IN REVIEW:

CONSUMER BANKRUPTCY LAW UPDATE

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DISCHARGEABILITY

Lamar, Archer & Cofrin, LLP v. Appling, 138 S.Ct. 1752 (2018)

- A statement regarding a single asset of the debtor may represent the debtor's financial position
- Such a statement must be in writing for a creditor to argue the debt is non-dischargeable as a false representation under 11 U.S.C. § 523(a)(2)(B)

Margulies v. USAA Cas. Ins. Co. (In re Margulies), 17-897(L), 17-1073(con) (2d Cir., 2018)

- A debt is non-dischargeable under 11 U.S.C. § 523(a)(6) if it is the result of a willful and malicious act
- An incident cannot be considered an accident for insurance purposes if it does not flow from "a chain of unintended though expected or foreseeable events that occurred after an intentional act"

VIOLATION OF AUTOMATIC STAY/ DISCHARGE INJUNCTION

Lorenzen v. Taggart (In re Taggart), 888 F.3d 438 (9th Cir. 2018), cert granted Jan. 7, 2019

- Even if the creditor's subjective good faith belief that it is not violating the discharge injunction is unreasonable, it prevents a finding of contempt

Anderson v. Credit One Bank, N.A. (In re Anderson), 884 F.3d 382 (2d Cir. 2018)

- A bankruptcy court has the discretion to deny arbitration in cases involving a "core proceeding" of bankruptcy law, such as the "fresh start" afforded by the discharge of debts
- Federal policy strongly favors arbitration in cases that do not involve "core proceedings"

Beckford v. Romano (In re Beckford), No. 13-20749 (AMN) (Bankr. D. Conn. 2018)

- Contempt and actual damages assessed against attorney who filed a motion for contempt in state court to collect on non-dischargeable divorce judgment debt while automatic stay was in place
- No contempt for violation of discharge injunction found for attorney's second filed motion for contempt since debt was non-dischargeable

COLLEGE CLAW-BACKS

Conn. Gen. Stat. § 52-552i (2017)

- A transfer is not voidable against higher education institutions if made by a parent or guardian on behalf of minor or adult child for undergraduate education

Boscarino v. Bd. of Trustees of Conn. State Univ. Sys. (In re Knight), No. 15-21646 (JJT) (Bankr. D. Conn. 2017)

- Trustee allowed to recover tuition payments made on behalf of adult son since Debtor did not receive "reasonably equivalent value"
- Definition of value limited to "economic benefits that preserve the net worth of the debtor's estate for the benefit of creditors"

Geltzer v. Oberlin College (In re Sterman), No. 18-01015 (MG) (Bankr. S.D.N.Y. 2018)

- Citing *In re Knight*, no reasonably equivalent value received under NY law or Bankruptcy Code
- Makes distinction that age of majority in NY is 21, versus 18 in CT

COLLEGE CLAW-BACKS CONT.

Novak v. University of Miami (In re Demitrus), 586 B.R. 88 (Bankr. D. Conn. 2018)

- Funds disbursed directly to a university by the Federal Direct PLUS Loan program are not property of the estate since debtor never has dominion or control over funds
- Federal statutes and regulations governing DOE loans do not support claims under UFTA and CUFTA

Roumeliotis v. Johnson & Wales Univ. (In re Demauro), No. 15-03011 (AMN) (Bankr. D. Conn. 2018)

- Relying on *In re Demitrus*, proceeds of Direct PLUS Loan disbursed to university did not "constitute an interest of the debtor in property subject to avoidance"

In re Adamo, 582 B.R. 267 (Bankr. E.D.N.Y 2018), *vacated and remanded Pergament v. Brooklyn Law School*, No. 1:18-CV-2201 (ARR) (E.D.N.Y Jan. 4, 2019)

- Universities are initial transferees no longer able to avail themselves of the good faith subsequent transferee defense once they no longer have any obligation to issue refunds

Mangan v. Univ. of Conn. (In re Hamadi), No. 17-02090 (JJT) (Bankr. D. Conn. 2019)

- University is initial transferee as to non-refundable payments, which can be avoided by the Trustee
- University is subsequent transferee with good faith defense as to refundable payments
- Post-petition payments are not avoidable under 11 U.S.C. § 548

IN REM RELIEF

T&M Building Co., Inc. v. Edwards, No. 19-20016 (JJT) (Bankr. D. Conn. 2019)

- Relief granted under 11 U.S.C. §§ 362(d)(1)
- Plan to pay $900k on $352k home over 10 years was unsustainable and unreasonable
- Modifications proposed expressly prohibited by 11 U.S.C. § 1123(b)(5)
- Plan failed to satisfy 11 U.S.C. §§ 129(a)(1), (2), (3), (7), and (11)

In re Valerie I. Carlsen, No. 19-20366 (JJT) (Bankr. D. Conn. 2019)

- Motion for relief from in rem order denied
- Debtor failed to demonstrate good cause for relief and clean hands with repeat filings, lack of tax payment, and years of deficiencies
- Debtor had knowledge of filings and authorized the same, despite claiming otherwise
- Laches applied to deny since Debtor had a year of notice and filed motion at last minute

EXEMPTIONS

Maresca v. Donovan, No. 16-30755 (AMN) (Bankr. D. Conn. 2018)

- Debtor's interest in real property periodically used as a dwelling by debtor's dependent is exempt under 11 U.S.C. § 522(d)(1)

Chorches v. Xiao (In re Xiao), No. 13-51186 (JJT) (Bankr. D. Conn. 2018)

- Retirement plan not protected by IRS determination letters
- Plan did not comply with IRC's requirements that plan
  - Be permanent
  - Meet minimum participation regulations, such as I.R.C. § 401(a)(26)
  - Meet exclusive benefit and non-discrimination requirements under I.R.C. §§ 401(a)(2) and (a)(4)
  - Be operated according to its own terms
- Plan "act[ed] as a subterfuge [to] distribute profits," violating 26 C.F.R. § 1.401-1(b)(3)

138 S.Ct. 1752
201 L.Ed.2d 102

LAMAR, ARCHER & COFRIN, LLP, Petitioner
v.
R. Scott APPLING.

No. 16–1215.

Supreme Court of the United States

Argued April 17, 2018.
Decided June 4, 2018.

Summaries:

Source: Justia

Appling owed about $60,000 to his law firm (Lamar), which threatened to withdraw representation and place a lien on its work product. Appling told Lamar that he could cover owed and future legal expenses with an expected tax refund, so Lamar continued representation. Appling used the refund, which was much less than he had stated, for business expenses, but told Lamar he was still waiting for the refund. Lamar completed pending litigation. Appling never paid. Lamar obtained a judgment. Appling filed for Chapter 7 bankruptcy. Lamar initiated an adversary proceeding, arguing that Appling's debt was nondischargeable under 11 U.S.C. 523(a)(2). Section 523(a)(2)(A) bars discharge of debts arising from "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's . . . financial condition." Subparagraph (B) bars discharge of debts arising from a materially false "statement . . . respecting the debtor's . . . financial condition" if that statement is "in writing." The Eleventh Circuit found that Appling made a statement "respecting" his "financial condition," which was not in writing. The Supreme Court affirmed. A statement about a single asset can be a "statement respecting the debtor's financial condition" under section 523(a)(2). A statement is "respecting" a debtor's financial condition if it has a direct relation to or impact on the debtor's overall financial status. A single asset has a direct relation to and impact on aggregate financial condition, so a statement about that asset bears on a debtor's overall financial condition and can help indicate whether a debtor is solvent or insolvent.

Gregory G. Garre, Washington, DC, for Petitioner.

Paul Hughes, Washington, DC, for Respondent.

Jeffrey E. Sandberg, for the United States as amicus curiae, by special leave of the Court, supporting the respondent.

Robert C. Lamar, David W. Davenport, Lamar, Archer & Cofrin, LLP, Atlanta, GA, Gregory G. Garre, Benjamin W. Snyder, Seung Wan (Andrew) Paik, Latham & Watkins LLP, Washington, DC, for Petitioner.

Eugene R. Fidell, Yale Law School, Supreme Court Clinic, New Haven, CT, Paul W. Hughes, Michael B. Kimberly, Andrew J. Pincus, Charles A. Rothfeld, Jonathan Weinberg, Mayer Brown LLP, Washington, DC, for Respondent.

[138 S.Ct. 1757]

Justice SOTOMAYOR delivered the opinion of the Court.[*]

The Bankruptcy Code prohibits debtors from discharging debts for money, property, services, or credit obtained by "false pretenses, a false representation, or actual fraud," 11 U.S.C. § 523(a)(2)(A), or, if made in writing, by a materially false "statement ... respecting the debtor's ... financial condition," § 523(a)(2)(B).

This case is about what constitutes a "statement respecting the debtor's financial condition." Does a statement about a single asset qualify, or must the statement be about the debtor's overall financial status? The answer matters to the parties because the false statements at issue concerned a single asset and were made orally. So, if the single-asset statements here qualify as "respecting the debtor's financial condition," § 523(a)(2)(B) poses no bar to discharge because they were not made in writing. If, however, the statements fall into the more general category of "false pretenses, ... false representation, or actual fraud," § 523(a)(2)(A), for which there is no writing requirement, the associated debt will be deemed nondischargeable.

The statutory language makes plain that a statement about a single asset can be a "statement respecting the debtor's financial condition." If that statement is not in writing, then, the associated debt may be discharged, even if the statement was false.

I

Respondent R. Scott Appling hired petitioner Lamar, Archer & Cofrin, LLP (Lamar), a law firm, to represent him in a business litigation. Appling fell behind on his legal bills, and by March 2005, he owed Lamar more than $60,000. Lamar informed Appling that if he did not pay the outstanding amount, the firm would withdraw from representation and place a lien on its work product until the bill was paid. The parties met in person that month, and Appling told his attorneys that he was expecting a tax refund of " ‘approximately $100,000,’ " enough to cover his owed and future legal fees. App. to Pet. for Cert. 3a. Lamar relied on this statement and continued to represent Appling without initiating collection of the overdue amount.

When Appling and his wife filed their tax return, however, the refund they requested was of just $60,718, and they ultimately received $59,851 in October 2005. Rather than paying Lamar, they spent the money on their business.

Appling and his attorneys met again in November 2005, and Appling told them that he had not yet received the refund. Lamar relied on that statement and agreed to complete the pending litigation and delay collection of the outstanding fees.

In March 2006, Lamar sent Appling its final invoice. Five years later, Appling still had not paid, so Lamar filed suit in Georgia state court and obtained a judgment for $104,179.60. Shortly thereafter, Appling and his wife filed for Chapter 7 bankruptcy.

Lamar initiated an adversary proceeding against Appling in Bankruptcy Court for the Middle District of Georgia. The firm argued that because Appling made fraudulent statements about his tax refund at the March and November 2005 meetings, his debt to Lamar was nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A), which

[138 S.Ct. 1758]

governs debts arising from "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's ... financial condition." Appling, in turn, moved to dismiss, contending that his alleged misrepresentations were "statement[s] ... respecting [his] financial condition" and were therefore governed by § 523(a)(2)(B), such that Lamar could not block discharge of the debt because the statements were not "in writing" as required for nondischargeability under that provision.

The Bankruptcy Court held that a statement regarding a single asset is not a "statement respecting the debtor's financial condition" and denied Appling's motion to dismiss. 500 B.R. 246, 252 (Bkrtcy.M.D.Ga.2013). After a trial, the Bankruptcy Court found that Appling knowingly made two false representations on which Lamar justifiably relied and that Lamar incurred damages as a result. It thus concluded that Appling's debt to Lamar was nondischargeable under § 523(a)(2)(A). 527 B.R. 545, 550–556 (M.D.Ga.2015). The District Court affirmed. 2016 WL 1183128 (M.D.Ga., Mar. 28, 2016).

The Court of Appeals for the Eleventh Circuit reversed. It held that " 'statement[s] respecting the debtor's ... financial condition' may include a statement about a single asset." *In re Appling,* 848 F.3d 953, 960 (2017). Because Appling's statements about his expected tax refund were not in writing, the Court of Appeals held that § 523(a)(2)(B) did not bar Appling from discharging his debt to Lamar. *Id.,* at 961.

The Court granted certiorari, 583 U.S. ––––, 138 S.Ct. 734, 199 L.Ed.2d 601 (2018), to resolve a conflict among the Courts of Appeals as to whether a statement about a single asset can be a "statement respecting the debtor's financial condition."[1] We agree with the Eleventh Circuit's conclusion and affirm.

II

A

One of the "main purpose[s]" of the federal bankruptcy system is "to aid the unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character." *Stellwagen v. Clum,* 245 U.S. 605, 617, 38 S.Ct. 215, 62 L.Ed. 507 (1918). To that end, the Bankruptcy Code contains broad provisions for the discharge of debts, subject to exceptions. One such exception is found in 11 U.S.C. § 523(a)(2), which provides that a discharge under Chapter 7, 11, 12, or 13 of the Bankruptcy Code "does not discharge an individual debtor from any debt ... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by" fraud. This exception is in keeping with the "basic policy animating the Code of affording relief only to an 'honest but unfortunate debtor.' " *Cohen v. de la Cruz,* 523 U.S. 213, 217, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998).

More specifically, § 523(a)(2) excepts from discharge debts arising from various forms of fraud. Subparagraph (A) bars discharge of debts arising from "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's ... financial condition." Subparagraph (B), in turn, bars discharge of

[138 S.Ct. 1759]

debts arising from a materially false "statement ... respecting the debtor's ... financial condition" if that statement is "in writing."

B

1

"Our interpretation of the Bankruptcy Code starts 'where all such inquiries must begin: with the language of the statute itself.' " *Ransom v. FIA Card Services, N. A.,* 562 U.S. 61, 69, 131 S.Ct. 716, 178 L.Ed.2d 603 (2011). As noted, the relevant statutory text is the phrase "statement respecting the debtor's financial condition." Because the Bankruptcy Code does not define the words "statement," "financial condition," or "respecting," we look to their ordinary meanings. See *ibid.*

There is no dispute as to the meaning of the first two terms. A "statement" is "the act or process of stating, reciting, or presenting orally or on paper; something stated as a report or narrative; a single declaration or remark." Webster's Third New International Dictionary 2229 (1976) (Webster's). As to "financial condition," the parties agree, as does the United States, that the term means one's overall financial status. See Brief for Petitioner 23; Brief for Respondent 25; Brief for United States as *Amicus Curiae* 12.

For our purposes, then, the key word in the statutory phrase is the preposition "respecting," which joins together "statement" and "financial condition." As a matter of ordinary usage, "respecting" means "in view of: considering; with regard or relation to: regarding; concerning." Webster's 1934; see also American Heritage Dictionary 1107 (1969) ("[i]n relation to; concerning"); Random House Dictionary of the English Language 1221 (1966) ("regarding; concerning"); Webster's New Twentieth Century Dictionary 1542 (2d ed. 1967) ("concerning; about; regarding; in regard to; relating to").

According to Lamar, these definitions reveal that " 'respecting' *can* be 'defined broadly,' " but that the word "isn't always used that way." Brief for Petitioner 27. The firm contends that " 'about,' " " 'concerning,' " " 'with reference to,' " and " 'as regards' " denote a more limited scope than " 'related to.' " Brief for Petitioner 3, 18, 27. When "respecting" is understood to have one of these more limited meanings, Lamar asserts, a "statement respecting the debtor's financial condition" is "a statement that is 'about,' or that makes 'reference to,' the debtor's overall financial state or well-being." *Id.,* at 27–28. Under that formulation, a formal financial statement providing a detailed accounting of one's assets and liabilities would qualify, as would statements like " 'Don't worry, I am above water,' " and " 'I am in good financial shape.' " *Id.,* at 19, 28. A statement about a single asset would not.

The Court finds no basis to conclude, however, at least in this context, that "related to" has a materially different meaning than "about," "concerning," "with reference to," and "as regards." The definitions of these words are overlapping and circular, with each one pointing to another in the group. "Relate" means "to be in relationship: have reference," and, in the context of the phrase "in relation to," "reference, respect." Webster's 1916; see also *id.,* at 18a (Explanatory Note 16.2). "About" means "with regard to," and is the equivalent of "concerning." *Id.,* at 5. "Concerning" means "relating to," and is the equivalent of "regarding, respecting, about." *Id.,* at 470. "Reference" means "the capability or character of alluding to or bearing on or directing attention to something," and is the equivalent of "relation" and "respect."

[138 S.Ct. 1760]

Id., at 1907. And "regard" means "to have relation to or bearing upon: relate to," and is the equivalent of "relation" and "respect." *Id.,* at 1911. The interconnected web formed by these words belies the clear distinction Lamar attempts to impose. Lamar also fails to put forth an example of a phrase in a legal context similar to the one at issue here in which toggling between "related to" and "about" has any pertinent significance.

Use of the word "respecting" in a legal context generally has a broadening effect, ensuring that the scope of a provision covers not only its subject but also matters relating to that subject. Cf. *Kleppe v. New Mexico,* 426 U.S. 529, 539, 96 S.Ct. 2285, 49 L.Ed.2d 34 (1976) (explaining that the Property Clause, "in broad terms, gives Congress the power to determine what are 'needful' rules 'respecting' the public lands," and should receive an "expansive reading").

Indeed, when asked to interpret statutory language including the phrase "relating to," which is one of the meanings of "respecting," this Court has typically read the relevant text expansively. See, *e.g., Coventry Health Care of Mo., Inc. v. Nevils,* 581 U.S. ––––, ––––, 137 S.Ct. 1190, 1197, 197 L.Ed.2d 572 (2017) (describing " 'relate to' " as "expansive" and noting that "Congress characteristically employs the phrase to reach any subject that has 'a connection with, or reference to,' the topics the statute enumerates"); *Morales v. Trans World Airlines, Inc.,* 504 U.S. 374, 378–390, 112 S.Ct. 2031, 119 L.Ed.2d 157 (1992) (explaining that " 'relating to' " has a "broad" ordinary meaning and accordingly holding that the Airline Deregulation Act of 1978 provision prohibiting the States from enforcing any law " 'relating to rates, routes, or services' " of any air carrier pre-empted any fare advertising guidelines that "would have a significant impact upon the airlines' ability to market their product, and hence a significant impact upon the fares they charge"); *Ingersoll–Rand Co. v. McClendon,* 498 U.S. 133, 139, 111 S.Ct. 478, 112 L.Ed.2d 474 (1990) (" 'A law "relates to" an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan.' Under this 'broad common-sense meaning,' a state law may 'relate to' a benefit plan ... even if the law is not specifically designed to affect such plans, or the effect is only indirect" (citation omitted)).

Advancing that same expansive approach here, Appling contends that a "statement respecting the debtor's financial condition" is "a statement that has a direct relation to, or impact on the balance of all of the debtor's assets and liabilities or the debtor's overall financial status." Brief for Respondent 17 (internal quotation marks and citations omitted). "A debtor's statement describing an individual asset or liability necessarily qualifies," Appling explains, because it "has a direct impact on the *sum* of his assets and liabilities." *Ibid.* "Put differently, a debtor's statement that describes the existence or value of a constituent element of the debtor's balance sheet or income statement qualifies as a 'statement respecting financial condition.' " *Ibid.*

The United States as *amicus curiae* supporting Appling offers a slightly different formulation. In its view, a "statement respecting the debtor's financial condition" includes "a representation about a debtor's asset that is offered as evidence of ability to pay." Brief for United States as *Amicus Curiae* 11. Although Appling does not include "ability to pay" in his proffered definition, he and the United States agree that their respective formulations are functionally the same and lead to the same

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results. See Tr. of Oral Arg. 50–52, 58. That is so because to establish the requisite materiality and reliance, a creditor opposing discharge must explain why it viewed the debtor's false representation as relevant to the decision to extend money, property, services, or credit. If a given statement did not actually serve as evidence of ability to pay, the creditor's explanation will not suffice to bar discharge. But if the creditor proves materiality and reliance, it will be clear the statement was one "respecting the debtor's financial condition." Whether a statement about a single asset served as evidence of ability to pay thus ultimately always factors into the § 523(a)(2) inquiry at some point.

We agree with both Appling and the United States that, given the ordinary meaning of "respecting," Lamar's preferred statutory construction—that a "statement respecting the debtor's financial condition" means only a statement that captures the debtor's overall financial status—must be rejected, for it reads "respecting" out of the statute. See *TRW Inc. v. Andrews,* 534 U.S. 19, 31, 122 S.Ct. 441, 151 L.Ed.2d 339 (2001) ("[A] statute ought ... to be so construed that ... no clause, sentence, or word shall be superfluous, void, or insignificant" (internal quotation marks omitted)). Had Congress intended § 523(a)(2)(B) to encompass only statements expressing the balance of a debtor's assets and liabilities, there are several ways in which it could have so specified, *e.g.,* "statement disclosing the debtor's financial condition" or "statement of the debtor's financial condition."[2] But Congress did not use such narrow language.

We also agree that a statement is "respecting" a debtor's financial condition if it has a direct relation to or impact on the debtor's overall financial status. A single asset has a direct relation to and impact on aggregate financial condition, so a statement about a single asset bears on a debtor's overall financial condition and can help indicate whether a debtor is solvent or insolvent, able to repay a given debt or not. Naturally, then, a statement about a single asset can be a "statement respecting the debtor's financial condition."

2

Further supporting the Court's conclusion is that Lamar's interpretation would yield incoherent results. On Lamar's view, the following would obtain: A misrepresentation about a single asset made in the context of a formal financial statement or balance sheet would constitute a "statement respecting the debtor's financial condition" and trigger § 523(a)(2)(B)'s heightened nondischargeability requirements, but the exact same misrepresentation made on its own, or in the context of a list of some but not all of the debtor's assets and liabilities, would not. Lamar does not explain why Congress would draw such seemingly arbitrary distinctions, where the ability to discharge a debt turns on the superficial packaging of a statement rather than its substantive content.

In addition, a highly general statement like, "I am above water," would need to be in writing to foreclose discharge, whereas a highly specific statement like, "I have $200,000 of equity in my house," would not. This, too, is inexplicably bizarre.

[138 S.Ct. 1762]

3

Lastly, the statutory history of the phrase "statement respecting the debtor's financial condition" corroborates our reading of the text. That language can be traced back to a 1926 amendment to the Bankruptcy Act of 1898 that prohibited discharge entirely to a debtor who had "obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing, or causing to be made or published, in any manner whatsoever, a materially false statement in writing respecting his financial condition." Act of May 27, 1926, § 6, 44 Stat. 663–664.

When Congress again amended this provision in 1960, it retained the "statement in writing respecting ... financial condition" language. See Act of July 12, 1960, Pub. L. 86–621, § 2, 74 Stat. 409. Congress then once more preserved that language when it rewrote and recodified the provision in the modern Bankruptcy Code as § 523(a)(2)(B).

Given the historical presence of the phrase "statement respecting the debtor's financial condition," lower courts had ample opportunity to weigh in on its meaning. Between 1926, when the phrase was introduced, and 1978, when Congress enacted the Bankruptcy Code, Courts of Appeals consistently construed the phrase to encompass statements addressing just one or some of a debtor's assets or liabilities.[3] When Congress used the materially same language in § 523(a)(2), it presumptively was aware of the longstanding judicial interpretation of the phrase and intended for it to retain its established meaning. See *Lorillard v. Pons,* 434 U.S. 575, 580, 98 S.Ct. 866, 55 L.Ed.2d 40 (1978) ("Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change"); *Bragdon v. Abbott,* 524 U.S. 624, 645, 118 S.Ct. 2196, 141 L.Ed.2d 540 (1998) ("When administrative and judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its administrative and judicial interpretations as well").

III

In addition to its plain-text arguments discussed and rejected above, see *supra,* at 1759 – 1760, Lamar contends that Appling's rule undermines the purpose of § 523(a)(2) in two ways. Neither argument is persuasive.

[138 S.Ct. 1763]

A

First, Lamar contends that Appling's construction gives § 523(a)(2)(B) an implausibly broad reach, such that little would be covered by § 523(a)(2)(A)'s general rule rendering nondischargeable debts arising from "false pretenses, a false representation, or actual fraud." That is not so. Decisions from this Court and several lower courts considering the application of § 523(a)(2)(A) demonstrate that the provision still retains significant function when the phrase "statement respecting the debtor's financial condition" is interpreted to encompass a statement about a single asset.

Section 523(a)(2)(A) has been applied when a debt arises from "forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation." *Husky Int'l Electronics, Inc. v. Ritz,* 578 U.S. ––––, ––––, 136 S.Ct. 1581, 1586, 194 L.Ed.2d 655 (2016).[4] It also has been used to bar the discharge of debts resulting from misrepresentations about the value of goods, property, and services.[5]

B

Second, Lamar asserts that Appling's interpretation is inconsistent with the overall principle that the Bankruptcy Code exists to afford relief only to the " 'honest but unfortunate debtor,' " *Cohen,* 523 U.S., at 217, 118 S.Ct. 1212, because it leaves "fraudsters" free to "swindle innocent victims for money, property or services by lying about their finances, then discharge the resulting debt in bankruptcy, just so long as they do so orally." Brief for Petitioner 35.

This general maxim, however, provides little support for Lamar's interpretation. The text of § 523(a)(2) plainly heightens the bar to discharge when the fraud at issue was effectuated via a "statement respecting the debtor's financial condition."[6] The heightened requirements, moreover, are not a shield for dishonest debtors. Rather, they reflect Congress' effort to balance the potential misuse of such statements by both debtors and creditors. As the Court has explained previously:

> "The House Report on the [Bankruptcy Reform Act of 1978] suggests that Congress wanted to moderate the burden on individuals who submitted false financial statements, not because lies about financial

[138 S.Ct. 1764]

> condition are less blameworthy than others, but because the relative equities might be affected by practices of consumer finance companies, which sometimes have encouraged such falsity by their borrowers for the very purpose of insulating their own claims from discharge." *Field v. Mans,* 516 U.S. 59, 76–77, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995).

Specifically, as detailed in *Field,* the House Report noted that consumer finance companies frequently collected information from loan applicants in ways designed to permit the companies to later use those statements as the basis for an exception to discharge. Commonly, a loan officer would instruct a loan applicant " 'to list only a few or only the most important of his debts' " on a form with too little space to supply a complete list of debts, even though the phrase, " 'I have no other debts,' " would be printed at the bottom of the form or the applicant would be

" 'instructed to write the phrase in his own handwriting.' " *Id.,* at 77, n. 13, 116 S.Ct. 437. If the debtor later filed for bankruptcy, the creditor would contend that the debtor had made misrepresentations in his loan application and the creditor would threaten litigation over excepting the debt from discharge. That threat was "often enough to induce the debtor to settle for a reduced sum," even where the merits of the nondischargeability claim were weak. H.R. Rep. No. 95–595, p. 131 (1977).

Notably, Lamar's interpretation of "statement respecting the debtor's financial condition" would not bring within § 523(a)(2)(B)'s reach the very types of statements the House Report described, because those debts-only statements said nothing about assets and thus did not communicate fully the debtor's overall financial status. Yet in *Field,* the Court explained that the heightened requirements for nondischargeability under § 523(a)(2)(B) were intended to address creditor abuse involving such statements. 516 U.S., at 76–77, 116 S.Ct. 437. Lamar's construction also would render § 523(a)(2)(B) subject to manipulation by creditors, frustrating the very end Congress sought to avoid when it set forth heightened requirements for rendering nondischargeable "statements respecting the debtor's financial condition." *Ibid .*

Finally, although Lamar tries to paint a picture of defenseless creditors swindled by lying debtors careful to make their financial representations orally, creditors are not powerless. They can still benefit from the protection of § 523(a)(2)(B) so long as they insist that the representations respecting the debtor's financial condition on which they rely in extending money, property, services, or credit are made in writing. Doing so will likely redound to their benefit, as such writings can foster accuracy at the outset of a transaction, reduce the incidence of fraud, and facilitate the more predictable, fair, and efficient resolution of any subsequent dispute.

IV

For the foregoing reasons, the Court holds that a statement about a single asset can be a "statement respecting the debtor's financial condition" under § 523(a)(2) of the Bankruptcy Code. The judgment of the Court of Appeals for the Eleventh Circuit is affirmed.

It is so ordered.

Notes:

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

[*] Justice THOMAS, Justice ALITO, and Justice GORSUCH join all but Part III–B of this opinion.

[1] Compare *In re Bandi,* 683 F.3d 671, 676 (C.A.5 2012) (a statement about a single asset is not a statement respecting the debtor's financial condition); *In re Joelson,* 427 F.3d 700, 714 (C.A.10 2005) (same), with *In re Appling,* 848 F.3d 953, 960 (C.A.11 2017) (a statement about a single asset can be a statement respecting the debtor's financial condition); *Engler v. Van Steinburg,* 744 F.2d 1060, 1061 (C.A.4 1984) (same).

[2] Congress in fact used just such "statement of" language elsewhere in the Bankruptcy Code. See, *e.g.,* 11 U.S.C. § 329(a) ("statement of the compensation paid"); § 521(a)(1)(B)(iii) ("statement of the debtor's financial affairs"); § 707(b)(2)(C) ("statement of the debtor's current monthly income").

[3] See, *e.g., Tenn v. First Hawaiian Bank,* 549 F.2d 1356, 1358 (C.A.9 1977) (*per curiam*) ("[A]ppellants' recordation of the deed which they knew was false for the purpose of

obtaining an extension of credit on the basis of an asset that they did not own was a false statement of financial condition" (citing *Scott v. Smith,* 232 F.2d 188, 190 (C.A.9 1956))); *In re Butler,* 425 F.2d 47, 49, 52 (C.A.3 1970) (affirming holding that a corporation's false statements as to select accounts receivable qualified as statements respecting financial condition); *Shainman v. Shear's of Affton, Inc.,* 387 F.2d 33, 38 (C.A.8 1967) ("A written statement purporting to set forth the true value of a major asset of a corporation, its inventory, is a statement respecting the financial condition of that corporation.... There is nothing in the language or legislative history of this section of the [Bankruptcy] Act to indicate that it was intended to apply only to complete financial statements in the accounting sense"); *Albinak v. Kuhn,* 149 F.2d 108, 110 (C.A.6 1945) ("No cases have been cited to us, and none has been found by careful examination, which confines a statement respecting one's financial condition as limited to a detailed statement of assets and liabilities"); *In re Weiner,* 103 F.2d 421, 423 (C.A.2 1939) (holding that a debtor's false statement about "an asset" that was pledged as collateral was a statement respecting financial condition).

[4] See also, *e.g., In re Tucker,* 539 B.R. 861, 868 (Bkrtcy.Ct.D.Idaho 2015) (holding nondischargeable under § 523(a)(2)(A) a debt arising from the overpayment of social security disability benefits to an individual who failed to report changes to his employment despite a legal duty to do so); *In re Drummond,* 530 B.R. 707, 710, and n. 3 (Bkrtcy.Ct.E.D.Ark.2015) (same, and concluding that "the requirement of the debtor to notify [the Social Security Administration] if she returns to work is not a statement that respects the debtor's financial condition").

[5] See, *e.g., In re Bocchino,* 794 F.3d 376, 380–383 (C.A.3 2015) (holding nondischargeable under § 523(a)(2)(A) civil judgment debts against a debtor-stockbroker who made misrepresentations about investments); *In re Cohen,* 106 F.3d 52, 54–55 (C.A.3 1997) (holding that a landlord's misrepresentations about the rent that legally could be charged for an apartment constituted fraud under § 523(a)(2)(A)); *United States v. Spicer,* 57 F.3d 1152, 1154, 1161 (C.A.D.C.1995) (holding nondischargeable under § 523(a)(2)(A) a settlement agreement owed to the Government based on an investor's misrepresentations of downpayment amounts in mortgage applications).

[6] In addition to the writing requirement, § 523(a)(2)(B) requires a creditor to show reasonable reliance. 11 U.S.C. § 523(a)(2)(B)(iii). Section 523(a)(2)(A), by contrast, requires only the lesser showing of "justifiable reliance." *Field v. Mans,* 516 U.S. 59, 61, 70–75, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995).

IN RE: JOSHUA SIMON MARGULIES, Debtor.

DENNIS HOUGH, Consolidated Appellant,

JOSHUA SIMON MARGULIES, Debtor - Appellant,
v.
USAA CASUALTY INSURANCE COMPANY, Appellee.

17-897(L)
17-1073(con)

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

May 11, 2018

SUMMARY ORDER

RULINGS BY SUMMARY ORDER DO NOT HAVE PRECEDENTIAL EFFECT. CITATION TO A SUMMARY ORDER FILED ON OR AFTER JANUARY 1, 2007, IS PERMITTED AND IS GOVERNED BY FEDERAL RULE OF APPELLATE PROCEDURE 32.1 AND THIS COURT'S LOCAL RULE 32.1.1. WHEN CITING A SUMMARY ORDER IN A DOCUMENT FILED WITH THIS COURT, A PARTY MUST CITE EITHER THE FEDERAL APPENDIX OR AN ELECTRONIC DATABASE (WITH THE NOTATION "SUMMARY ORDER"). A PARTY CITING A SUMMARY ORDER MUST SERVE A COPY OF IT ON ANY PARTY NOT REPRESENTED BY COUNSEL.

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, 40 Foley Square, in the City of New York on the 11th day of May, two thousand eighteen.

Present: ROSEMARY S. POOLER, REENA RAGGI, CHRISTOPHER F. DRONEY, *Circuit Judges*.

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Appearing for Appellant Dennis Hough:

Matthew N. Kane (Stanley K. Shapiro, New York, N.Y., *on the brief*), Donnelly, Conroy & Gelhaar, LLP, Boston, MA.

Appearing for Appellant Joshua Simon Margulies:

Donna Aldea (Joshua Margulies, pro se, Lynbrook, N.Y., *on the brief*), Barket Marion Epstein & Kearon LLP, Garden City, N.Y.

Appearing for Appellee:

Howard Smith (Peter M. Sartorius, *on the brief*), Olshan Frome & Wolosky LLP, New York, N.Y.

Appeal from the United States District Court for the Southern District of New York (Failla, *J.*; Bernstein, *B.J.*).

ON CONSIDERATION WHEREOF, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of said District Court be and it hereby is **AFFIRMED.**

Joshua Margulies and Dennis Hough appeal from the March 20, 2017 opinion and order of the United States District Court for the Southern District of New York (Failla, *J.*) affirming the decision of the United States Bankruptcy Court for the Southern District of New York (Bernstein, *J.*) that held (1) the state court default judgment Hough obtained against Margulies was a non-dischargeable debt; and (2) that no coverage was available under certain insurance policies USAA Casualty Insurance Company provided to Margulies. We assume the parties' familiarity with the underlying facts, procedural history, and specification of issues for review.

"When a bankruptcy appeal reaches us after district court review of the bankruptcy court order, our review of the bankruptcy court order is plenary." *In re N. New Eng. Tele. Operations LLC*, 795 F.3d 343, 346 (2d Cir. 2015) (internal quotation marks omitted). "In undertaking this plenary review, we independently review the factual determinations and legal conclusions of the bankruptcy court, evaluating the bankruptcy court's legal conclusions *de novo* and its factual findings for clear error." *Id.* (internal quotation marks omitted).

The facts, as found by the bankruptcy court and as relevant to this appeal, are that Hough was working as a flag man on Sixth Avenue in Manhattan on the morning of August 3, 2000. *Margulies v. Hough*, 541 B.R. 156, 159-60 (Bankr. S.D.N.Y. 2015) ("*Margulies V*"). Margulies was driving a car north on Sixth Avenue, on his way to a meeting with former Governor Mario Cuomo, and running late. *Id.* Hough was managing traffic. *Id.* Margulies was stopped by Hough, his car first in the line. *Id.* at 160. Hough continued to hold traffic, even though it seemed no vehicles were entering or exiting the construction site. *Id.* Margulies became increasingly impatient as he watched the traffic light at 23rd Street pass through two full cycles without seeing any trucks enter or leave the site. *Id.* Margulies testified he made eye contact with Hough to communicate his intention to proceed when the light turned green regardless of Hough's instructions. *Id.* When the light changed to green, Margulies lifted his foot off the brakes and his car rolled forward slowly. *Id.* Hough was not in Margulies's lane when the car started moving forward, but stepped back into the lane when the car was about a car length away. *Id.* Hough did not move, and the car continued to move forward. *Id.* Margulies testified that he expected Hough to move, and thought Hough was staying put "simply to annoy" Margulies. *Id.* Margulies continued to allow the car to move forward toward Hough, and did not apply the brakes until

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after the car hit Hough. *Id.* Margulies saw Hough fall and get back up, stated he assumed Hough was unhurt, and continued up Sixth Avenue to his meeting. *Id.* Margulies subsequently pled guilty to misdemeanor assault in the third degree under N.Y. Penal Law § 120.00(2) (McKinney 2015). *Id.*

Hough sued Margulies for negligence in New York State Court. *Id.* Neither Margulies nor USAA defended the action and, following an inquest, Hough obtained a $4.8 million default judgment (the "Judgment"). *Id.* Hough then sued USAA to collect on the Judgment pursuant to N.Y. Insurance Law § 3420. *Id.* After Margulies filed for Chapter 7 bankruptcy, Hough commenced an adversary proceeding seeking (1) to have the Judgment declared non-dischargeable under 11 U.S.C. § 523(a)(6) on the ground that Margulies acted willfully and maliciously; or (2) to have USAA held liable for the Judgment up to the limits of the insurance policies pursuant to N.Y. Insurance Law 3420 because the incident was an "accident" within the meaning of the policies. *Id.* In November 2015, the bankruptcy court found that (1) "Margulies acted willfully and maliciously, and accordingly, [that] his debt to Hough is not dischargeable" and (2) "the incident that gave rise to Hough's injury was not an accident within the meaning of New York's insurance law, and hence, is not covered by the USAA policies issued to Margulies." *Id.* at 159. The district court affirmed. *Margulies v. Hough*, 566 B.R. 318 (S.D.N.Y. 2017) ("*Margulies VI*").

Hough first argues that the bankruptcy court erred in finding that the incident was not an "accident" within the meaning of the USAA policies, such that the insurer is not obligated to provide coverage. Hough argues that the Judgment establishes that Margulies's actions were negligent, not intentional, and res judicata bars reconsideration of the issue of Margulies's intent in federal court. We disagree. "Under the doctrine of res judicata, a final adjudication of a claim on the merits precludes relitigation of that claim and all claims arising out of the same transaction or series of transactions by a party or those in privity with a party." *Tromba v. E. Fed. Sav. Bank FSB*, 148 A.D.3d 753, 754 (2d Dept. 2017) (citations omitted). "A judgment of default which has not been vacated is conclusive for res judicata purposes, and encompasses the issues which were raised or could have been raised in the prior action." *Id.* (citations omitted). Moreover, an insurer may defend against a Section 3420 action to collect on a judgment by demonstrating that coverage is not available under the policy. *K2 Inv. Grp., LLC v. Am. Guar. & Liab. Ins. Co.*, 22 N.Y.3d 578, 585-86 (2014). Here, the issue of Margulies's intent could not be raised in the state court negligence action. Margulies could not defeat Hough's allegations of negligence by arguing that his actions were, in fact, intentional. *See Hough v. USAA Cas. Ins.* Co., 940 N.Y.S.2d 41, 42 (1st Dept. 2012) ("[USAA's disclaimer of its duty to defend [Margulies] in the underlying action does not bar it from asserting that [Margulies] injured [Hough] intentionally, because that assertion is not a defense extending to the merits of [Hough's] personal injury claims against [Margulies].").

We also agree with the bankruptcy court that because Margulies acted intentionally, the incident is not an occurrence within the meaning of the USAA policies and no coverage is available. Under New York insurance law, an injury is "intentionally caused" and thus not accidental if the "damages . . . flow directly and immediately from an intended act" rather than "a chain of unintended though expected or foreseeable events that occurred after an intentional act." *Brooklyn Law Sch. v. Aetna Cas. & Surety Co.*, 849 F.2d 788, 789 (2d Cir. 1989) (citation

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omitted). Hough's injuries flowed directly and immediately from Margulies's decision not to apply the car's brakes until after the car struck Hough. The incident was not an accident within the meaning of New York law, and thus was not an occurrence as defined in the USAA policies.

Margulies challenges the bankruptcy court's holding that the debt is nondischargeable. A debt is not dischargeable when the debt was incurred because of the "willful and malicious injury by the debtor to another." 11 U.S.C. § 523(a)(6). This exception to discharge requires a plaintiff to prove three elements: (1) "debtor acted willfully," (2) "debtor acted maliciously," and (3) "debtor's willful and malicious actions caused injury to the plaintiff or the plaintiff's property." *Guggenheim Capital LLC v. Birnbaum*, 513 B.R. 788, 802-03 (Bankr. E.D.N.Y. 2014). In the context of Section 523(a), "willful . . . means deliberate or intentional," similar to the willful intent necessary to commit an intentional tort. *Kawaauhau v. Geiger*, 523 U.S. 57, 61 n.3 (1998) (internal quotation marks omitted); *See general* Restatement (Second) of Torts § 8A cmt. a (1964) (stating that intent is evident when "the actor . . . believes that the consequences are substantially certain to result from [her act].").

While it is an open question in this Circuit as to whether the "substantial certainty" test is objective or subjective, we need not settle the issue today. Under either the objective or subjective standard, Margulies's decision not to apply the car's brakes until after the car struck Hough can only be viewed as a decision from which consequences are substantially certain to flow. There is no error.

For the same reasons, we agree with the bankruptcy court's determination that Margulies's actions were malicious. An act is malicious when "wrongful and without just cause or excuse, even in the absence of personal hatred, spite, or ill-will." *Ball v. A.O. Smith Corp.*, 451 F.3d 66, 69 (2d Cir. 2006) (internal quotation marks omitted). A finding of malice does not require a "specific intent to harm or injure," but rather "is implied when anyone of reasonable intelligence knows that the act in question is contrary to commonly accepted duties in the ordinary relationships among people, and injurious to another." *Aldus Green Co. v. Mitchell*, 227 B.R. 45, 51 (B.R. S.D.N.Y. 1998) (internal quotation marks and brackets omitted). Failing to attempt to apply a car's brakes before striking a person standing in front of the car satisfies the standard for malice.

We have considered the remainder of Hough and Margulies's arguments and find them to be without merit. Accordingly, the order of the district court hereby is AFFIRMED.

FOR THE COURT:
Catherine O'Hagan Wolfe, Clerk

888 F.3d 438

IN RE Bradley Weston TAGGART, Debtor,

Shelley A. Lorenzen, Executor of Estate of Stuart Brown ; Terry W. Emmert; Keith Jehnke; Sherwood Park Business Center, LLC, Appellants,
v.
Bradley Weston Taggart, Appellee.

In re Bradley Weston Taggart, Debtor,

Bradley Weston Taggart, Appellant,
v.
Shelley A. Lorenzen, Executor of Estate of Stuart Brown ; Terry W. Emmert; Keith Jehnke; Sherwood Park Business Center, LLC, Appellees.

In re Bradley Weston Taggart, Debtor,

Bradley Weston Taggart, Appellant,
v.
Terry W. Emmert; Keith Jehnke; Sherwood Park Business Center, LLC; Shelley A. Lorenzen, Executor of Estate of Stuart Brown, Appellees.

In re Bradley Weston Taggart, Debtor,

Shelley A. Lorenzen, Executor of the Estate of Stuart Brown, Appellant,
v.
Bradley Weston Taggart, Appellee.

In re Bradley Weston Taggart, Debtor,

Terry W. Emmert; Keith Jehnke; Sherwood Park Business Center, LLC, Appellants,
v.
Bradley Weston Taggart, Appellee.

In re Bradley Weston Taggart, Debtor,

Shelley A. Lorenzen, Executor of Estate of Stuart Brown, Appellant,
v.
Bradley Weston Taggart, Appellee.

In re Bradley Weston Taggart, Debtor,

Terry W. Emmert; Keith Jehnke; Sherwood Park Business Center, LLC, Appellants,
v.
Bradley Weston Taggart, Appellee.

No. 16-35402
No. 16-60032
No. 16-60033
No. 16-60039
No. 16-60040
No. 16-60042
No. 16-60043

United States Court of Appeals, Ninth Circuit.

Argued and Submitted October 3, 2017, Portland, Oregon
Filed April 23, 2018

Summaries:

Source: Justia

The Ninth Circuit affirmed the Bankruptcy Appellate Panel's opinion reversing the bankruptcy court's order entering contempt sanctions against creditors for knowingly violating the discharge injunction in the Chapter 7 case. The panel held that creditors did not knowingly violate the discharge injunction because they had a subjective good faith belief that the discharge injunction did not apply to their state-court claim for post-petition attorneys' fees. The panel explained that creditors' subjective good faith belief, even if unreasonable, insulated them from a finding of contempt.

John Martin Berman (argued) and Damon J. Petticord, Tigard, Oregon, for Bradley Weston Taggart.

Janet M. Schroer (argued), Hart Wagner LLP, Portland, Oregon; James Ray Streinz, Streinz Law Office, Portland, Oregon, for Shelley Lorenzen.

Hollis Keith McMilan (argued), Hollis K. McMilan P.C., Portland, Oregon, for Terry W. Emmert, Keith Jehnke, and Sherwood Park Business Center LLC.

Before: Edward Leavy, Richard A. Paez, and Carlos T. Bea, Circuit Judges.

BEA, Circuit Judge:

This case arises out of a complex set of bankruptcy proceedings. Appellant Bradley Taggart was a real estate developer who owned a 25% interest in Sherwood Park Business Center, LLC ("SPBC"). Appellees and Cross-Appellants Terry Emmert and Keith Jehnke also each owned a 25% interest in SPBC. In 2007, Taggart allegedly transferred his share of SBPC to his attorney in this action, John Berman.

When Emmert and Jehnke learned that Taggart had transferred his interest in SPBC to Berman, they sued Taggart and Berman in Oregon state court, asserting that the transfer breached SPBC's operating agreement because Taggart did not provide the notice required to allow Emmert and Jehnke to exercise their right of first refusal to buy Taggart's interest at the agreed upon price. The state court action also sought attorneys' fees pursuant to the operating agreement. Taggart filed an answer to the state court action, sought to dismiss the action, and filed a counterclaim for attorneys' fees pursuant to the operating agreement.

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On November 4, 2009, shortly before trial in the state court action, Taggart filed a voluntary Chapter 7 Bankruptcy petition (the "Petition"). The state court action was stayed pending the resolution of Taggart's bankruptcy Petition. On February 23, 2010, Taggart received his discharge in the bankruptcy proceedings.

After the discharge, Emmert and Jehnke, represented by attorney Stuart Brown, continued the state court action against Berman and Taggart. As part of the litigation, Brown served Taggart with a subpoena for a deposition. Taggart, represented by Berman, moved for a protective order that would allow him not to appear at the deposition, but the state trial court never ruled on the motion. Nonetheless, Taggart appeared for his deposition.

Prior to trial, Berman moved on Taggart's behalf to dismiss the claims against Taggart in light of the bankruptcy discharge. The state court denied the motion, finding that Taggart was a necessary party to Emmert and Jehnke's claims seeking to expel Taggart from SPBC, but the parties agreed that no monetary judgment would be awarded against Taggart. Taggart did not appear at or participate in the trial, but Berman orally renewed his motion to dismiss on Taggart's behalf at the close of evidence. The state court once again denied the motion.

After trial, the state court issued findings of fact and conclusions of law that unwound the transfer of Taggart's interest in SPBC to Berman and expelled Taggart from SPBC. Brown submitted a proposed judgment, to which Berman objected. Taggart appeared at the hearing for entry of the judgment and provided testimony and argument.

Following the hearing, the state court entered a judgment that allowed any party to petition for attorneys' fees. The litigation regarding attorneys' fees spawned a complex, interrelated web of litigation in both state and federal court.

First, Brown filed a petition for attorneys' fees in state court on behalf of SPBC, Emmert, and Jehnke. Brown's fee petition sought to recover fees against both Berman and Taggart, but limited the request for fees against Taggart to those fees that had been incurred after the date of Taggart's bankruptcy discharge. In the fee petition, Brown alerted the state court to the existence of Taggart's bankruptcy discharge and argued that Taggart could still be held liable for attorneys' fees incurred after Taggart's discharge because Taggart had "returned to the fray." That is, SPBC, Emmert, and Jehnke claimed Taggart had willingly engaged in opposing them in the state court action after Taggart obtained his bankruptcy discharge. Taggart opposed Brown's petition for attorneys' fees, arguing his bankruptcy discharge barred any claim for attorneys' fees, whether they were incurred before or after his discharge in bankruptcy.

While the attorneys' fee petition was pending in state court, Taggart moved the bankruptcy court to reopen his bankruptcy proceeding. The day the bankruptcy court reopened Taggart's bankruptcy proceeding, Taggart filed a motion seeking to hold Brown, Jehnke, Emmert, and SPBC (collectively, the "Creditors") in contempt for violating the discharge by seeking an award of attorneys' fees against him in the state court action.

Meanwhile, the state trial court issued a ruling awarding attorneys' fees to SPBC, but not Jehnke and Emmert. The state court ruled that Taggart could be held liable for attorneys' fees that were incurred after his bankruptcy discharge

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because he had "returned to the fray."[1] Taggart appealed the state court's determination to the Oregon Court of Appeals. *See Sherwood Park Bus. Ctr., LLC v. Taggart* , 267 Or.App. 217, 341 P.3d 96 (2014).

Subsequently, the bankruptcy court denied Taggart's motion for contempt, finding that the state court had correctly decided the issue: whether Taggart had indeed "returned to the fray." Taggart appealed the bankruptcy court's ruling to the district court. The district court reversed, finding that Taggart's actions were insufficient to constitute a "return to the fray" and, as a result, the discharge injunction barred the attorneys' fee claim. The district court remanded to the bankruptcy court for a determination of whether the Creditors "knowingly violated the discharge injunction in seeking attorney fees."[2]

On remand, the bankruptcy court found the Creditors had knowingly violated the discharge injunction by seeking attorneys' fees in the state action and entered an order holding them in contempt. Following further proceedings, the bankruptcy court awarded sanctions against SPBC, Emmert, Jehnke, and Brown's estate,[3] pursuant to the court's contempt ruling.

The Creditors appealed the bankruptcy court's contempt ruling to the Bankruptcy Appellate Panel ("BAP"). On appeal, the BAP reversed the bankruptcy court's finding of contempt. The BAP reasoned that the Creditors could not be held in contempt unless they "knowingly" violated the discharge injunction. Because the BAP found that the Creditors had a good faith belief that the discharge injunction did not apply to their attorneys' fee claim, it concluded that they had not "knowingly" violated the discharge injunction.

In the meantime, the Oregon Court of Appeals reversed the state trial court's ruling regarding attorneys' fees. *See Taggart* , 341 P.3d at 102–04. In line with the district court, the Oregon Court of Appeals held that Taggart's actions were not sufficiently affirmative or voluntary to constitute a "return to the fray." *Id* . As a result, the court concluded that the discharge injunction barred the recovery of attorneys' fees. *Id* .

Ultimately, the Creditors were barred from pursuing attorneys' fees against Taggart by the rulings of both the district court and the Oregon Court of Appeals. Additionally, due to the BAP's ruling, the Creditors were not liable for sanctions for knowingly violating the discharge injunction by seeking attorneys' fees against Taggart in the state court litigation.

Taggart filed a notice of appeal challenging the BAP's decision to reverse the bankruptcy court's contempt findings against the Creditors. The Creditors filed a notice of cross-appeal challenging the district court's ruling that Taggart had not returned to the fray in the state court litigation.

I

We begin with Taggart's appeal, in which he argues that the BAP committed

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reversible error when it held that the Creditors could not be held in contempt because they did not *knowingly* violate the discharge injunction. A discharge under Chapter 7 of the bankruptcy code "discharges the debtor from all debts that arose before the date of the" bankruptcy petition. 11 U.S.C. § 727(b). Once issued, the discharge "operates as an injunction against the commencement or continuation of an action ... to collect, recover or offset any such debt as a personal liability of the debtor." 11 U.S.C. § 524(a)(2). A bankruptcy court may enforce the discharge injunction by holding a party in contempt for knowingly violating the discharge. *In re Zilog, Inc.* , 450 F.3d 996, 1007 (9th Cir. 2006).

In this case, after the district court concluded that Taggart had not "returned to the fray," it remanded the case to the bankruptcy court for a determination of whether the Creditors should be held in contempt. The bankruptcy court determined that the Creditors were aware of the discharge order, but proceeded with their efforts to recover attorneys' fees from Taggart. The bankruptcy court concluded that it was irrelevant whether the Creditors held a subjective good faith belief that the discharge injunction did not apply to their claim. As a result, the bankruptcy court held that the Creditors had committed a knowing violation of the discharge injunction and it held them in contempt.

On appeal, the BAP reversed. The BAP concluded that the Creditors had a subjective good faith belief that their claim was exempt from the discharge injunction. In light of this good faith belief, the BAP held that the Creditors did not "knowingly" violate the discharge injunction, even though an actual violation had occurred.

We review the BAP's decisions de novo. *In re Filtercorp, Inc.* , 163 F.3d 570, 576 (9th Cir. 1998). The bankruptcy court's decision to impose contempt sanctions is reviewed for an abuse of discretion. *In re Dyer* , 322 F.3d 1178, 1191 (9th Cir. 2003). A bankruptcy court abuses its discretion if its decision is based on an incorrect legal rule, or if its "application of the correct legal standard was (1) 'illogical,' (2) 'implausible,' or (3) without 'support in inferences that may be drawn from the facts in the record.' " *United States v. Hinkson* , 585 F.3d 1247, 1262 (9th Cir. 2009) (quoting *Anderson v. City of Bessemer* , 470 U.S. 564, 577, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985)).

"The standard for finding a party in civil contempt is well settled: The moving party has the burden of showing by clear and convincing evidence that the contemnors violated a specific and definite order of the court. The burden then shifts to the contemnors to demonstrate why they were unable to comply." *In re Bennett* , 298 F.3d 1059, 1069 (9th Cir. 2002) (quoting *F.T.C. v. Affordable Media,* 179 F.3d 1228, 1239 (9th Cir.1999)). As noted above, a bankruptcy court may hold a party in contempt for knowingly violating the discharge injunction. *Zilog* , 450 F.3d at 1007. We have adopted a two-part test for determining the propriety of a contempt sanction in the context of a discharge injunction: "[T]o justify sanctions, the movant must prove that the creditor (1) knew the discharge injunction was applicable and (2) intended the actions which violated the injunction." *Bennett* , 298 F.3d at 1069.

Only the first prong of the test is at issue here. To satisfy the first prong, knowledge of the applicability of the injunction must be proved as a matter of fact and may not be inferred simply because the creditor knew of the bankruptcy proceeding. *Zilog* , 450 F.3d at 1007–08 ; *see also Dyer* , 322 F.3d at 1191–92 (rejecting

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an attempt to infer knowledge of the automatic stay based on knowledge of the bankruptcy proceedings in the context of a contempt ruling).[4] Additionally, the creditor's good faith belief that the discharge injunction does not apply to the creditor's claim precludes a finding of contempt, even if the creditor's belief is unreasonable. *Zilog* , 450 F.3d at 1009 n.14 ("To the extent that the deficient notices [from the bankruptcy court and opposing counsel] led the [creditors] to believe, even unreasonably, that the discharge injunction did not apply to their claims because they were not affected by the bankruptcy, this would preclude a finding of willfulness.").

In this case, the bankruptcy court abused its discretion by concluding that the Creditors knowingly violated the discharge injunction. Specifically, the bankruptcy court abused its discretion by applying an incorrect rule of law. *See Hinkson* , 585 F.3d at 1262. The bankruptcy court held that a good faith belief that the discharge injunction was inapplicable to the Creditors' claims was irrelevant for purposes of determining whether there was a "knowing" violation of the discharge injunction. This holding conflicts with *Zilog* , where we stated that even an unreasonable belief that the discharge injunction did not apply to a creditor's claims would preclude a finding of contempt. 450 F.3d at 1009 n.14.

It is true, as Taggart points out, that language from our prior opinions in *Bennett* and *Dyer* appears to be somewhat in tension with *Zilog* .[5] However, neither *Bennett* nor *Dyer* held that a creditor's subjective good faith belief that the discharge injunction is inapplicable is irrelevant to the contempt analysis. In fact, *Bennett* expressly states that the creditor must know that the discharge injunction is "applicable" to the creditor's claims, and *Dyer* cited that holding with approval. *Bennett* , 298 F.3d at 1069 ; *Dyer* , 322 F.3d at 1192. Regardless, *Zilog* 's statement of the law is clear, directly addresses the question at issue in here, and is binding on this court.

In this case, as the BAP found, the Creditors possessed a good faith belief that the discharge injunction did not apply to their claims based on their contention that Taggart had "returned to the fray," and Taggart does not contend otherwise. Much like the creditors in *Zilog* relied on statements by the debtor's counsel and the bankruptcy court in concluding that their claims were not impacted by the discharge injunction, the Creditors relied on the state court's judgment that the discharge injunction did not apply to their claim for post-petition attorneys' fees. Although the Creditors—like the creditors in *Zilog* —were ultimately incorrect, their good faith belief, even if unreasonable, insulated them from a finding of contempt. *Zilog* , 450 F.3d at 1009 n.14. As a result, the BAP did not err when it reversed the contempt sanctions

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entered by the bankruptcy court against the Creditors.

II

Because we have determined that the Creditors cannot be held in contempt for any alleged violation of the discharge injunction, we need not reach the arguments raised in the Creditors' cross-appeal regarding the district court's holding that the Creditors violated the discharge injunction by seeking an attorneys' fee award in the state court litigation.[6] Even if the Creditors did violate the discharge injunction—and we express no opinion as to whether they did or did not—they cannot be held in contempt for that alleged violation. As discussed above, they acted pursuant to their good faith belief that, due to Taggart's "return to the fray," the discharge injunction did not apply to their claims. As a result, we decline to reach the issues raised by the Creditors' Cross-Appeal.

III

In light of the above, we **AFFIRM** the BAP's opinion reversing the bankruptcy court's order entering contempt sanctions against the Creditors.

Notes:

[1] Whether Taggart had "returned to the fray" was significant because if a debtor "returns to the fray" by engaging in post-bankruptcy petition litigation, a creditor may seek an attorneys' fee award if the new litigation was not within the "fair contemplation of the parties" prior to the bankruptcy petition. *See In re Castellino Villas, A. K. F. LLC* , 836 F.3d 1028, 1034–37 (9th Cir. 2016).

[2] Emmert, Brown, Jehnke, and SPBC filed a notice of appeal of the district court's decision. This court dismissed the appeal because the district court's ruling was not a final order.

[3] Brown passed away in 2013. Shelley Lorenzen represents Brown in this litigation as the executor of his estate.

[4] Although *Dyer* dealt with a violation of the automatic stay, rather than a violation of the discharge injunction, the sanctions at issue were not imposed under the bankruptcy code provision that specifically allows sanctions for a violation of the automatic stay, 11 U.S.C. § 362(h). *Dyer* , 322 F.3d at 1189. Rather, sanctions were imposed under the bankruptcy court's 11 U.S.C. § 105(a) contempt authority, thereby invoking the standard that applies when there is a violation of the discharge injunction. *Id.*

[5] Taggart specifically highlights language from *Dyer* , which states: "In determining whether the contemnor violated the stay, the focus 'is not on the subjective beliefs or intent of the contemnors in complying with the order, but whether in fact their conduct complied with the order at issue.' " 322 F.3d at 1191 (quoting *In re Hardy* , 97 F.3d 1384, 1390 (11th Cir. 1996)).

[6] After the district court's decision in this case, but before the parties completed their briefing in our court, another Ninth Circuit panel issued an opinion in *In re Castellino Villas, A. K. F. LLC* , 836 F.3d 1028, 1034 (9th Cir. 2016). Lorenzen's briefing to this court recognized the *Castellino Villas* opinion and noted that, in Lorenzen's view, *Castellino Villas* commands resolution of whether Creditors violated the discharge against the Creditors. At the time of briefing in this case, *Castellino Villas* had been decided, but could have been reheard by an en banc panel of this court or overturned or modified by the Supreme Court. Lorenzen requested that we deem her cross-appeal withdrawn if *Castellino Villas* was not overturned or modified. Because *Castellino Villas* has neither been overturned nor modified, we grant Lorenzen's request to withdraw her cross-appeal. Therefore, we do not address it.

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884 F.3d 382

IN RE: Orrin S. ANDERSON, aka Orrin S. Anderson, aka Orinn Scott Anderson, Debtor,

Orrin S. Anderson, on behalf of himself and all others similarly situated, AKA Orinn Scott Anderson Plaintiff–Appellee,
v.
Credit One Bank, N.A., Defendant–Appellant.

Docket No. 16-2496
August Term, 2017

United States Court of Appeals, Second Circuit.

Argued: October 11, 2017
Decided: March 7, 2018

Summaries:

Source: Justia

The Second Circuit affirmed the bankruptcy court's denial of Credit One's motion to compel arbitration on the basis of a clause in the cardholder agreement between Credit One and debtor. The court held that debtor's claim was not arbitrable because the dispute concerned a core bankruptcy proceeding and arbitrating the matter would present an inherent conflict with the goals of the Bankruptcy Code. In this case, the successful discharge of debt was not merely important to the Bankruptcy Code, it was its principal goal. The court explained that an attempt to coerce debtors to pay a discharged debt was thus an attempt to undo the effect of the discharge order and the bankruptcy proceeding itself.

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GEORGE F. CARPINELLO, Boies, Schiller & Flexner LLP (Adam R. Shaw, Anne M. Nardacci, and Jenna C. Smith, on the brief), Albany, NY, for Plaintiff–Appellee.

Charles Juntikka, New York, NY, for Plaintiff–Appellee (on the brief).

NOAH A. LEVINE, Wilmer Cutler Pickering Hale and Dorr, LLP (Alan E. Schoenfeld, on the brief), New York, NY, for Defendant–Appellant.

Michael David Slodov, Chagrin Falls, OH, for Defendant–Appellant.

Evan M. Tager, Charles E. Harris, II, Mayer Brown LLP, Washington, D.C. and Kate Comerford Todd, Warren Postman, U.S. Chamber Litigation Center, for amicus curiae Chamber of Commerce of the United States of America in support of Defendant–Appellant Credit One Bank, N.A.

Tara Twomey, National Consumer Bankruptcy Rights Center, San Jose, CA for amici curiae Professors Ralph Brubaker, Robert M. Lawless, and Bruce A. Markell in support of Plaintiff–Appellee Orrin S. Anderson.

Before: POOLER and DRONEY, Circuit Judges, and RAMOS,[1] District Judge.

POOLER, Circuit Judge:

Orrin Anderson was a credit card holder with a predecessor in interest of Credit One Bank, N.A. ("Credit One"). In March 2012, Credit One "charged off" Anderson's delinquent debt, which means the bank changed the outstanding debt from a receivable to a loss in its own accounting books. It then sold Anderson's debt to a third-party buyer. Credit One reported the change in the debt's status to Equifax, Experian, and Transunion, indicating both that the bank had made the internal accounting change and that the debt remained unpaid. In 2014, Anderson filed a voluntary Chapter 7 bankruptcy petition and on May 6, 2014, the United States Bankruptcy

Court for the Southern District of New York (Drain, *Bankr. J.*) entered a Discharge of Debtor Order of Final Decree ("discharge order") providing that Anderson was released from all dischargeable debts and closing Anderson's Chapter 7 case.

Anderson's claim arises from Credit One's subsequent refusal to remove the charge-off notation on Anderson's credit reports. In December 2014, the bankruptcy court permitted Anderson to reopen his bankruptcy proceeding to file a putative class action complaint against Credit One. Anderson alleges that Credit One's refusal to change his credit report is an attempt to coerce Anderson into paying a debt that has already been discharged through bankruptcy, which is a violation of the bankruptcy court's discharge injunction. Credit One moved to stay the proceedings and initiate arbitration in accordance with an arbitration clause in Anderson's cardholder agreement with the bank. The bankruptcy court held that Anderson's claim was non-arbitrable because it was a core bankruptcy proceeding that went to the heart of the "fresh start" guaranteed to debtors under the Bankruptcy Code.

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Credit One filed an interlocutory appeal of that ruling, as is its right under the Federal Arbitration Act ("FAA"), 9 U.S.C. § 16(a)(1)(A). The United States District Court for the Southern District of New York (Nelson S. Román, *J* .) agreed with the bankruptcy court.

The parties agree that the issues raised concern "core" bankruptcy proceedings and arguments regarding legislative history and statutory text were not raised below. Accordingly, we need only inquire whether arbitration of Anderson's claim presents the sort of inherent conflict with the Bankruptcy Code that would overcome the strong congressional preference for arbitration. We agree with both lower courts that Anderson's complaint is non-arbitrable. The successful discharge of debt is not merely important to the Bankruptcy Code, it is its principal goal. An attempt to coerce debtors to pay a discharged debt is thus an attempt to undo the effect of the discharge order and the bankruptcy proceeding itself. Because the issue strikes at the heart of the bankruptcy court's unique powers to enforce its own orders, we affirm the district court decision below.

BACKGROUND

In October 2002, Orrin Anderson opened a credit card account with First National Bank of Marin, a predecessor in interest to Credit One. Anderson's cardholder agreement contained an arbitration clause. Specifically, the arbitration agreement provided that "either [Anderson] or [Credit One] may, without the other's consent, require that any controversy or dispute ... be submitted to mandatory, binding arbitration." App'x at 426.

In September 2011, Anderson's Credit One credit card account became delinquent and it remained so until March 2012, when Credit One "charged off" Anderson's account, reclassifying Anderson's debt from a receivable to a loss.[2] In May 2012, Credit One sold Anderson's account to a third-party debt buyer. Credit One then reported the charge-off and the sale of the debt to the three major consumer credit reporting agencies Equifax, Experian, and TransUnion.

On January 31, 2014, Anderson filed a voluntary Chapter 7 bankruptcy petition in the United States Bankruptcy Court for the Southern District of New York. On May 6, 2014, the bankruptcy court entered an order discharging all of Anderson's dischargeable debts and closing his Chapter 7 case.

In September 2014, Anderson contacted Credit One and asked it to remove the charge-off from his credit reports since the Credit

One debt had been discharged in his bankruptcy proceeding. Credit One refused to contact the credit reporting agencies to correct the alleged error on Anderson's credit report. In October 2014, Anderson moved the bankruptcy court to reopen his case in order to pursue Credit One's "alleged violations of [Anderson's] discharge injunction." App'x at 94. In December 2014, the bankruptcy court granted Anderson's motion to reopen. Anderson thereafter filed an amended class action complaint in the bankruptcy court alleging that Credit One violated 11 U.S.C. § 524(a)(2) by "knowingly and willfully failing to update the credit reports of [c]lass [m]embers to signify the debts owing to [Credit One] have been discharged in bankruptcy." App'x at 398. In essence,

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Anderson alleged that Credit One refused to update the credit reporting agencies regarding the discharged debt in an effort to coerce payment on the discharged debt in violation of the Section 524 discharge injunction.

In March 2015, Credit One moved to compel arbitration pursuant to the terms of the cardholder agreement and to stay the bankruptcy proceeding. The bankruptcy court held a hearing on May 5 and denied the motion nine days later. Less than a month later, in June 2015, Credit One filed an interlocutory appeal of the bankruptcy court's denial of its motion to compel arbitration. The district court affirmed the decision of the bankruptcy court a year later in June 2016. Credit One timely filed its notice of appeal on July 13, 2016 and amended it on July 26, 2016.

Oral argument was held in this case on October 11, 2017, and thereafter we asked the parties to submit supplemental briefs on the issue of mootness, given Credit One's stipulation that it would update the credit reports of Anderson and other consumers. The parties submitted supplemental briefs on October 23, 2017. We agree with both parties that the stipulation does not moot the appeal because the question presented and the relief sought both remain unsettled, such that we retain jurisdiction under Article III's "case" or "controversy" requirement. U.S. Const. Art. III, § 2. We thus proceed to consider the merits of the appeal.

DISCUSSION

I. Standard of Review

We begin by clarifying the standard of review, which we acknowledge has been inconsistently or imprecisely applied by this Court. Bankruptcy court decisions are subject to appellate review in the first instance by the district court, pursuant to the statutory scheme articulated in 28 U.S.C. § 158. The same section of the code grants jurisdiction to the circuit courts to hear appeals from the orders of the district court. 28 U.S.C. § 158(d). Because this scheme requires district courts to operate as appellate courts, we engage in plenary, or de novo, review of the district court decision. *In re Manville Forest Prod's Corp.* , 896 F.2d 1384, 1388 (2d Cir. 1990). We then apply the same standard of review employed by the district court to the decision of the bankruptcy court. Accordingly, we review the bankruptcy court's findings of fact for clear error and its legal determinations de novo. *In re U.S. Lines, Inc.* , 197 F.3d 631, 640–41 (2d Cir. 1999).

Our review procedure is further dictated by the specific question posed in this case, namely, whether arbitration may be compelled in this bankruptcy proceeding. That decision requires the bankruptcy court to determine first whether the issue involves a "core" or "non-core" proceeding, a distinction we explain in more detail below (*infra* , section II). If the proceeding is "non-core," "bankruptcy courts generally must stay" the proceedings "in favor of arbitration." *In re Crysen/Montenay Energy Co.* , 226 F.3d 160, 166 (2d Cir. 2000). If the matter involves a core proceeding, the bankruptcy court is tasked with engaging in a "particularized inquiry into the nature of the claim and the facts of the specific bankruptcy." *MBNA America Bank, N.A. v. Hill* , 436 F.3d 104, 108 (2d Cir. 2006). If the bankruptcy court determines that arbitration would create a "severe conflict" with the purposes of the Bankruptcy Code, it has discretion to conclude that "Congress intended to override the Arbitration Act's general policy favoring the enforcement of arbitration agreements." *Id.*

We agree with the district court that the bankruptcy court's discretion to

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stay the proceedings may only be exercised if it properly assessed the factors related to the analysis of a potential inherent conflict between arbitration and the bankruptcy proceeding. *In re Anderson* , 553 B.R. 221, 226 (S.D.N.Y. 2016). Accordingly, we engage in de novo review of the bankruptcy court's determinations of whether the proceeding is core or non-core and whether arbitration would present the sort of "severe conflict" with the Bankruptcy Code that would make arbitration inappropriate. *Hill* , 436 F.3d at 108. If we find that the bankruptcy court's legal analysis was correct, we review its decision to either stay the proceedings or decline to enforce the arbitration agreement for abuse of discretion. *In re U.S. Lines, Inc.,* 197 F.3d at 641.

In sum, we engage in clear error review of the bankruptcy court's findings of fact and de novo review of its legal conclusions, including the core/non-core and inherent conflict determinations. If an inherent conflict was properly found, we review the decision of whether to enforce the arbitration agreement under the deferential abuse of discretion standard.

II. Core or Non–Core Bankruptcy Proceedings

In 28 U.S.C. § 157(b)(2), Congress articulated "a nonexclusive list of 16 types of proceedings" that it considers "core" to the power of the bankruptcy court. *Wellness Intern. Network, Ltd. v. Sharif* , ––– U.S. ––––, 135 S.Ct. 1932, 1940, 191 L.Ed.2d 911 (2015). Proceedings that are "core" are those that involve "more pressing bankruptcy concerns." *In re U.S. Lines, Inc.* , 197 F.3d at 640. We have previously held that "[b]ankruptcy courts are more likely to have discretion to refuse to compel arbitration of core bankruptcy matters." *Hill* , 436 F.3d at 108.

The parties now agree that Anderson's claim is a "core" proceeding. Accordingly, we turn to the second step of our analysis to assess whether Congress intended for this statutory right to be non-arbitrable, such that the bankruptcy court had the discretion to refuse to compel arbitration in this core bankruptcy proceeding.

III. Congressional Intent

The Federal Arbitration Act, 9 U.S.C. § 1 et seq.,"establishes a federal policy favoring arbitration." *Shearson/American Exp., Inc. v. McMahon* , 482 U.S. 220, 226, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987) (internal quotation marks omitted). This preference, however, is not absolute. "Like any statutory directive, the Arbitration Act's mandate may be overridden by a contrary congressional command." *Id.* , 482 U.S. at 226, 107 S.Ct. 2332. In *McMahon* , the Supreme Court explained that "[t]he burden is on the party opposing arbitration ... to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue." *Id.* at 227, 107 S.Ct. 2332. Congressional intent may be discerned through the "text or legislative history, or from an inherent conflict between arbitration and the statute's underlying purposes." *Id.* (internal quotation marks and citation omitted).

Though Credit One argues on appeal that intent may be discerned through the text and legislative history, these arguments were not raised by either party below. *In re Anderson* , 553 B.R. at 227 n. 3. "It is well settled that arguments not presented to the district court are considered waived and generally will not be considered for the first time on appeal." *Anderson Group, LLC v. City of Saratoga Springs* , 805 F.3d 34, 50 (2d Cir. 2015). That doctrine is, of course, "entirely prudential" and we are free to consider the arguments if doing so is "necessary to

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avoid a manifest injustice." *Id.* (quoting *In re Nortel Networks Corp. Sec. Litig.* , 539 F.3d 129, 132 (2d Cir. 2008)). However, "the circumstances normally do not militate in favor of an exercise of discretion to address ... new arguments on appeal where those arguments were available to the parties below and they proffer no reason for their failure to raise the arguments below." *In re Nortel* , 539 F.3d at 133 (internal brackets and quotation marks omitted). Accordingly, we decline to consider this new argument, which did not benefit from the analysis of the courts below. We need only consider whether there is an "inherent conflict between arbitration" and the Bankruptcy Code. *McMahon* , 482 U.S. at 227, 107 S.Ct. 2332.

In order to determine whether enforcement of an arbitration agreement would present an inherent conflict with the Bankruptcy Code, we must engage in a

> particularized inquiry into the nature of the claim and the facts of the specific bankruptcy. The objectives of the Bankruptcy Code relevant to this inquiry include the goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of a bankruptcy court to enforce its own orders.

Hill , 436 F.3d at 108 (citation and internal quotation marks omitted).

Anderson's complaint alleges that Credit One violated Section 524(a)(2) of the Bankruptcy Code when it refused to update the credit reports of Anderson and other similarly situated discharged debtors. Section 524(a)(2) explains that a bankruptcy discharge

> 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 debt is waived.

11 U.S.C. § 524(a)(2). Anderson specifically alleges that Credit One's refusal reflected "a policy of not updating credit information for debts that are discharged in bankruptcy for the purpose of collecting such discharged debt." App'x at 384. Anderson has alleged that debt marked as "charged off" rather than "discharged" is more valuable to third-party debt buyers, who believe debtors will be compelled to pay the discharged debt in order to clear this negative item from their credit reports. This behavior is alleged to occur across a class of debtors.

It is well established that the discharge is the foundation upon which all other portions of the Bankruptcy Code are built. We have observed that "[b]ankruptcy allows honest but unfortunate debtors an opportunity to reorder their financial affairs and get a fresh start. This is accomplished through the statutory discharge of preexisting debts." *In re DeTrano* , 326 F.3d 319, 322 (2d Cir. 2003) (internal citation and quotation marks omitted). We have previously described the "fresh start" procured by discharge as the "central purpose of the bankruptcy code" as shaped by Congress, permitting debtors to obtain a "fresh start in life and a clear field unburdened by the existence of old debts." *In re Bogdanovich* , 292 F.3d 104, 107 (2d Cir. 2002). The "fresh start" is only possible if the discharge injunction crafted by Congress and issued by the bankruptcy court is fully heeded by creditors and prevents their further collection efforts. Violations of the injunction damage the foundation on which the debtor's fresh start is built.

Following the logic of *U.S. Lines* and *Hill* , we find that arbitration of a claim based on an alleged violation of Section 524(a)(2) would "seriously jeopardize a

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particular core bankruptcy proceeding." *In re U.S. Lines* , *Inc.* , 197 F.3d at 641. We come to this conclusion because 1) the discharge injunction is integral to the bankruptcy court's ability to provide debtors with the fresh start that is the very purpose of the Code; 2) the claim regards an ongoing bankruptcy matter that requires continuing court supervision; and 3) the equitable powers of the bankruptcy court to enforce its own injunctions are central to the structure of the Code. The fact that Anderson's claim comes in the form of a putative class action does not undermine this conclusion.

First, discharge is the paramount tool used to effectuate the central goal of bankruptcy: providing debtors a fresh financial start. In *Hill* , we distinguished that claim involving an automatic stay in an already-closed bankruptcy case from those cases in which courts found the claim to be non-arbitrable by observing that "Hill's bankruptcy case is now closed and she has been discharged. Resolution of Hill's claim against MBNA therefore cannot affect an ongoing reorganization, and arbitration would not conflict with the objectives of the automatic stay." 436 F.3d at 110. In the non-arbitrable cases on the other hand, "resolution of the arbitrable claims directly implicated matters central to the purposes and policies of the Bankruptcy Code." 436 F.3d at 110. Because there is no matter more "central to the purposes and policies of the Bankruptcy Code" than the fresh start provided by discharge, arbitration of Anderson's claim presents an inherent conflict with the Bankruptcy Code.

Second, Anderson's claims center on alleged violations of a discharge injunction that was still eligible for active enforcement. In *Hill* , we declined to find an inherent conflict where the debtor "no longer require[d] the protection of the stay to ensure her fresh start" because her estate had been fully administered. *Id.* Anderson alleges the precise opposite in his complaint: the protection of the injunction is absolutely required to ensure his fresh start and he claims that Credit One violated that injunction. Unlike the automatic stay, the discharge injunction is likely to be central to bankruptcy long after the close of proceedings. The automatic stay exists only while bankruptcy proceedings continue to ensure the status quo ante, while the integrity of the discharge must be protected indefinitely. Enforcement of the arbitration agreement in this case would interfere with the fresh start bankruptcy promises debtors, which would create an inherent conflict with the Code.

Third, enforcement of injunctions is a crucial pillar of the powers of the bankruptcy courts and central to the statutory scheme. In *Hill* , we recognized that we must consider "the undisputed power of a bankruptcy court to enforce its own orders" as part of our "particularized inquiry into the nature of the claim and the facts of a specific bankruptcy."

Id. at 108 (quoting *Ins. Co. of N. Am. v. NGC Settlement Trust & Asbestos Claims Mgmt. Corp. (In re Nat'l Gypsum Co.),* 118 F.3d 1056, 1069 (5th Cir.1997)). In that case we determined that the automatic stay "which arises by operation of statutory law" was not "so closely related to an injunction that the bankruptcy court is uniquely able to interpret and enforce its provisions." *Id.* at 110. Credit One argues that because the discharge injunction at issue here is based in a statute and executed by the court as a standard form using boilerplate language, the unique powers of the bankruptcy court are not implicated in any meaningful way. We disagree. Though the discharge injunction itself is statutory and thus a standard part of every bankruptcy proceeding, the bankruptcy court retains a unique expertise in interpreting its own injunctions and

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determining when they have been violated. Congress afforded the bankruptcy courts wide latitude to enforce their own orders, specifically granting these specialty courts the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code.[3] 11 U.S.C. § 105(a). We have previously observed that "[t]he statutory contempt powers given to a bankruptcy court under § 105(a) complement the inherent powers of a federal court to enforce its own orders." *In re Kalikow* , 602 F.3d 82, 96 (2d Cir. 2010). Neither the statutory basis of the order nor its similarity—even uniformity—across bankruptcy cases alters the simple fact that the discharge injunction is an order issued by the bankruptcy court and that the bankruptcy court alone possesses the power and unique expertise to enforce it. Indeed, as one set of amici noted in their brief, violations of a discharge injunction simply cannot be described as "claims" subject to arbitration and the typical tools of contract interpretation.[4] Instead, violations of this court-ordered injunction are enforceable only by the bankruptcy court and only by a contempt citation.

The power to enforce an injunction is complementary to the duty to obey the injunction, which the Supreme Court has described as a duty borne out of "respect for judicial process." *GTE Sylvania, Inc. v. Consumers Union of U.S., Inc.* , 445 U.S. 375, 387, 100 S.Ct. 1194, 63 L.Ed.2d 467 (1980) (internal quotation marks omitted). That same respect for judicial process requires us to hold that the bankruptcy court alone has the power to enforce the discharge injunction in Section 524. Arbitration of the claim would thus present an inherent conflict with the Bankruptcy Code.

Finally, we observe that the class action nature of this case does not alter our analysis. In *Hill* , we determined that the posture of the claim as a putative class action cut against Hill's argument that her claim was "integral to her individual bankruptcy proceeding." *Hill* , 436 F.3d at 110. We have already established that the discharge injunction at issue here is absolutely integral to the fresh start assured by Anderson's bankruptcy proceeding. We further observe that the procedural posture of Hill's case—a claim for a violation of the automatic stay long after that stay had been rendered moot by the closing of her bankruptcy case—undercut the claimed class action in a way that is not relevant to Anderson's claim. We observed that like the plaintiff herself, many of Hill's putative class members were "no longer in bankruptcy proceedings" and that the effort to tie her claim to this larger amorphous class suggested a "lack of close connection" between her claim and the underlying bankruptcy case. *Id.* Again, the facts of Anderson's case are easily distinguished. Unlike violations of stays that are already mooted by the conclusion of bankruptcy proceedings, where the putative class members are all allegedly victims of willful violations of the discharge injunction issued by the bankruptcy court there is a continuing disruption of the debtors' ability to obtain their fresh starts.

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IV. Discretion to Decline to Enforce Arbitration Agreement

Because we determine there is an inherent conflict between arbitration of Anderson's claim and the Bankruptcy Code, we must also assess whether the bankruptcy court abused its discretion in declining to enforce the arbitration agreement.

We find that the bankruptcy court "properly considered the conflicting policies in accordance with law." *In re U.S. Lines, Inc.* , 197 F.3d at 641. Accordingly, "we acknowledge its exercise of discretion and show due deference to its determination that arbitration will seriously jeopardize a particular core bankruptcy proceeding." *Id.* We hold that the bankruptcy court did not abuse its discretion by denying Credit One's motion to compel arbitration in this case.

CONCLUSION

For the foregoing reasons, we hereby AFFIRM the order of the district court and REMAND for further proceedings consistent with this opinion.

Notes:

[1] Judge Edgardo Ramos, United States District Court for the Southern District of New York, sitting by designation.

[2] Federal regulations require banks to "charge off" debt that is past due by over 180 days. Uniform Retail Credit Classification and Account Management Policy, 65 Fed. Reg. 36,903, 36,904 (June 12, 2000) ("[O]pen-end retail loans that become past due 180 cumulative days from the contractual due date should be classified Loss and charged off").

[3] Though it is not at issue in this appeal, amici persuasively document the judicial and legislative history of the discharge injunction and argue that "Congress deliberately chose to vest the federal court presiding over a bankruptcy case with injunctive power to enforce the bankruptcy debtor's discharge." Amici Curiae Br. for Professors Ralph Brubaker, Robert M. Lawless, and Bruce A. Markell in Support of Appellee ("Amici Professors Br.") at 5.

[4] Amici Professors Br. at 12–18.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT
NEW HAVEN DIVISION

In re: ALMAN ANDREW BECKFORD, *Debtor*	Case No.: 13-20749 (AMN) Chapter 7
ALMAN ANDREW BECKFORD, *Movant* v. MICHAEL ROMANO, ESQ. *Respondent*	Re: ECF No. 51, 140, 198

MEMORANDUM OF DECISION AND ORDER ASSESSING ACTUAL DAMAGES FOR VIOLATION OF THE AUTOMATIC STAY

APPEARANCES

Alman Andrew Beckford 1481 Albany Avenue Hartford, CT 06112	*Pro Se* Debtor
Jon P. Newton, Esq. Reid and Riege, P.C. One Financial Plaza, 21st Floor Hartford, CT 06103	Counsel for Michael Romano, Esq.

I. INTRODUCTION

The remaining issue pending before the court is an assessment of actual damages incurred by the debtor, Alman Andrew Beckford ("Mr. Beckford") resulting from Attorney Michael Romano's ("Attorney Romano") violation of the automatic stay. The court assumes the parties' familiarity with the factual background of this dispute as set forth in the court's Decision dated June 23, 2017 ("June 2017 Decision"). For the reasons that follow, the court finds that Mr. Beckford's actual damages relating to Attorney Romano's violation of automatic stay equal One Hundred Ninety-Two ($192.00) Dollars.

II. FACTUAL BACKGROUND

Previously, in October of 2015, Mr. Beckford filed a motion for contempt against Attorney Romano for violating the Bankruptcy Code's automatic stay provision and the discharge injunction (the "Motion for Sanctions"). ECF No. 51; *See* U.S.C. §§ 362, 524. Mr. Beckford sought damages for Attorney Romano's act of filing a motion for contempt in State Court against Mr. Beckford for his failure to pay the Home Depot bill as required under the dissolution of marriage judgment ("2013 Motion for Contempt") in the Divorce Action (defined in ECF No. 140), on July 25, 2013, at a time when the automatic stay was in effect.[1] Additionally, Mr. Beckford requested damages for Attorney Romano's act of filing a second motion for contempt in the Divorce Action on June 11, 2014 – after the entry of Mr. Beckford's chapter 7 discharge – alleging in pertinent part that Mr. Beckford had failed to comply with the dissolution of marriage judgment by neglecting to pay the Home Depot bill ("2014 Motion for Contempt").

On June 23, 2017, the court entered the June 2017 Decision regarding Mr. Beckford's Motion for Sanctions concluding that Attorney Romano violated the automatic stay by filing the 2013 Motion for Contempt[2] but did not violate the discharge injunction by filing the 2014 Motion for Contempt. ECF No. 140. Both Mr. Beckford and Attorney Romano sought reconsideration of the June 2017 Decision. ECF Nos. 151,162.

On March 28, 2018, the court denied both motions seeking reconsideration. ECF No. 198. Thereafter, on August 7, 2018 the court held an evidentiary hearing (the

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[1] It is undisputed the 2013 Motion for Contempt was not ruled upon by the State Court. See also, footnote 2.

[2] The court notes there was no finding that Attorney Romano pursued the 2013 Motion for Contempt before the state court by asking that it be ruled upon. Rather, the court found the act of filing the motion with the state court was not an accident (i.e. in this context, was "willful") and had the effect of violating the stay. The June 2017 Decision did not determine whether Mr. Beckford sustained any actual damages from the filing of the motion during the time the stay was in effect. The existence and amount of Mr. Beckford's actual damages are the remaining issues addressed by this Order.

"Hearing") limited to the presentation of evidence regarding actual damages incurred by Mr. Beckford. ECF Nos. 210, 229. During the hearing, Mr. Beckford presented testimony from Attorney Romano and himself and introduced five exhibits into evidence.[3] At the conclusion of the hearing, the court took the issue of actual damages under advisement.

III. RELEVANT LAW

Violations of the automatic stay are punishable as contempt of court. Pursuant to 11 U.S.C. § 362(k)(1), acts that violate the stay are void, and if "willful," provide a proper basis for the assessment of damages. 11 U.S.C. § 362(k)(1). Section 362(k)(1), states in relevant part:

> 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.
> 11 U.S.C. § 362(k)(1).

A debtor "bears the burden of proving that damages were actually incurred." *In re Sturman*, 2011 WL 4472412, at *3 (S.D.N.Y. 2011)(where no injury results from the violation of the automatic stay, an award of damages is clearly inappropriate); *see also*, *In re Manchanda*, No. 16-10222 (JLG), 2016 WL 3034693, at *5 (Bankr.S.D.N.Y. 2016)(debtor must prove by a preponderance of the evidence that he or she suffered damages)(*unpublished)*.

"The automatic stay afforded by section 362 is intended to be a shield protecting debtors and their estates, and should not be used as a sword for their enrichment." *In re Skeen*, 248 B.R. 312, 321 (Bankr. E.D. Tenn. 2000)(*quoting McHenry v. Key Bank (In re McHenry)*, 179 B.R. 165, 168-69 (B.A.P. 9th Cir. 1995). "[M]any courts have expressed

[3] The court admitted five exhibits as full exhibits, including Exhibit 2, 5, 6, 7, and 8. The court notes that these exhibits were also used during the deposition of Mr. Beckford and the court adopted the numbering of the exhibits as used during the deposition.

reluctance to award fees and costs in the absence of other actual damages for fear of encouraging an "'excessively litigious approach'" to minor stay violations. *See In re Sturman*, 2011 U.S. Dist. LEXIS 109599, at *11 (S.D.N.Y. Sep. 26, 2011)(*citing In re Saratoga Springs Plastic Surgery, PC*, No. 03 Civ. 896 (DNH), 2005 U.S. Dist. LEXIS 2046, 2005 WL 357207, at *5 n.4 (N.D.N.Y. Feb. 11, 2005); *In re Whitt*, 79 B.R. 611, 616 (Bankr. E.D. Pa. 1987) (concluding such awards “are allowable only to embellish 'actual damages”)).

IV. DISCUSSION

The limited question before the court is the determination of actual damages suffered by Mr. Beckford resulting from Attorney Romano’s act of filing the 2013 Motion for Contempt. During the Hearing, Attorney Romano testified that after filing the 2013 Motion for Contempt he did not pursue it further. Attorney Romano also testified that the procedure in the Connecticut Superior Court to pursue a filed motion is that the moving party must ‘mark it ready’ for hearing and notify the other party of such marking. Attorney Romano did not notify Mr. Beckford of a hearing on the 2013 Motion for Contempt because Attorney Romano did not mark the Motion ready. Attorney Romano stated that he did not withdraw the 2013 Motion for Contempt because, according to him, the Superior Court considers null any motion not pursued after four months.

Mr. Beckford testified that in 2013 he was employed by the City of Hartford as a heavy equipment truck driver. While Mr. Beckford did not present any time records for 2013, he provided Exhibit 2 as a record of his pay for the period of November 2014 through August 2018. Mr. Beckford also testified that his pay rate in 2013 was about $23.00 or $24.00 per hour and that there was no change in rate from 2013 to 2014. He further testified that his normal shift was 8 hours per day. As a result of the 2013 Motion for Contempt, Mr. Beckford stated that he missed 1 day's worth of work when he attended a hearing in the Connecticut Superior Court because he believed the Motion would be heard that day. The court takes judicial notice of the Order dated August 28, 2013 ("August 2013 Order") entered in the Connecticut Superior Court case entitled *Marilyn Beckford v. Alman Beckford,* bearing case number HHD-FA-11-4058161-S. The August 2013 Order provided that:

> [Mr. Beckford's] Objection to Motion (Motion 149.00) is marked "off" for today because Plaintiff's Contempt Motion [Mr. Beckford] is objecting to is not on the docket today and it does not appear that Plaintiff is actively pursuing the Contempt Motion at this time. If Plaintiff does reclaim the Contempt Motion in question at a later date, [Mr. Beckford] may reclaim his objection (Motion 149.00) at that time.
>
> ECF No. 75-6.

The August 2013 Order also noted that the defendant – Mr. Beckford – was the only one present on that day. ECF No. 75-6. Attorney Romano argued that the court should not award damages for the day of work Mr. Beckford missed because under the Superior Court procedure, Attorney Romano did not mark the 2013 Motion for Contempt ready and, thus, Mr. Beckford was not required to attend court on August 28, 2013.

While the court acknowledges the Superior Court procedure described by Attorney Romano, the court also recognizes Mr. Beckford's *pro se* status and the potential for a *pro se* party to be unfamiliar with the procedure. The court declines to place the burden of the procedural mistake on Mr. Beckford, and allows him compensation for the day he took off from work to appear in the Superior Court to defend himself from the 2013 Motion for Contempt.[4] Accordingly, the court concludes that actual damages for a day of work

[4] The court notes that in Exhibit 5, Mr. Beckford stated that numerous days were spent researching and preparing his objection to the 2013 Motion for Contempt. However, none of the evidence submitted suggests that Mr. Beckford missed days of work or incurred actual damages for this time. "*Pro se* litigants cannot recover attorney's fees as an item of actual damages in an action under § 362(k)." *Carter v. Barber (In re Carter)*, Docket No. EC-14-1581-KuDTa, 2016 Bankr. LEXIS 1838, at *15 (B.A.P. 9th Cir. Apr. 22, 2016); *see also In re Dugas*, Docket No. 94-10027, 2009 Bankr. LEXIS 3231, at *40-41 n.62 (Bankr. E.D. Tex. Oct. 13, 2009)("Though § 362(k) also permits a recovery of attorney's fees, the Debtors in this case

[$24.00 x 8 hours] in the amount of One Hundred and Ninety Two Dollars ($192.00) should be awarded to Mr. Beckford.

Additionally, upon questions from this court regarding time spent prosecuting his Motion for Sanctions filed with this court, Mr. Beckford testified that he took a day off from work for every hearing. The court notes that it conducted a preliminary hearing on November 12, 2015 regarding Mr. Beckford's Motion for Sanctions that the court continued to December 21, 2015. Mr. Beckford appeared at both hearings. However, the evidence is not clear that Mr. Beckford in fact incurred a loss of time at work for these two hearing dates. Mr. Beckford testified that he often worked the third-shift. Further, Exhibit 2 indicates that throughout November and December 2015, Mr. Beckford received an increased pay rate for working third-shift and received compensation for a full 40 hours of regular time, without using any sick or vacation time. Based on this record, the court is unable to determine that Mr. Beckford missed days at work to attend the hearings in November and December 2015. Accordingly, the court concludes that Mr. Beckford failed to show by a preponderance of the evidence that he incurred actual damages in prosecuting his Motion for Sanctions in 2015.

As for subsequent hearings held in this court on this Motion for Sanctions, including October 26, 2017, August 1, 2018, and August 7, 2018, Mr. Beckford failed to show actual damages. Mr. Beckford testified that he has not worked since November 2016. As previously stated, a *pro se* litigant is not entitled to attorneys' fees for self-representation.

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acted in a pro se capacity and, [], statutory attorneys' fees cannot be awarded to pro se litigants, such as the Debtors, unless such a person is, in fact, an attorney.")(*citing McLean v. Int'l Harvester Co.*, 902 F.2d 372 (5th Cir. 1990)); *see also Milton v. Rosicki, Rosicki & Associates, P.C.,* Docket No. 02 CV 3052 (NG), 2007 U.S. Dist. LEXIS 56872, at *10 (E.D.N.Y. Aug. 3, 2007)("*pro se* plaintiff cannot recover attorney's fees for representing himself in FDCPA action").

During the Hearing, Mr. Beckford spent a significant amount of time presenting evidence regarding a significant work-related injury that occurred on November 18, 2014, and the resulting medical bills. Mr. Beckford argued that his injury at his job was the result of undue stress caused by Attorney Romano's act of filing the 2013 Motion for Contempt.

The court has considered Mr. Beckford's arguments but finds them unpersuasive. The act of filing the 2013 Motion for Contempt was a single, discreet action after which Attorney Romano took no further steps to prosecute the Motion. The courts finds the act of filing the 2013 Motion for Contempt far too removed from the November 2014 work-related accident to conclude the accident and the related medical bills were actual damages stemming from Attorney Romano's violation of the automatic stay.

V. CONCLUSION

For the reasons stated above, the court concludes that Mr. Beckford incurred actual damages of One Hundred Ninety-Two Dollars ($192.00) from missing a day at work to attend a hearing in Superior Court resulting from Attorney Romano's act of filing the 2013 Motion for Contempt in violation of the automatic stay. Accordingly, it is

ORDERED: That, on or before September 5, 2018, Attorney Romano shall pay Alman Andrew Beckford the sum of One Hundred Ninety-Two Dollars ($192.00) as actual damages pursuant to 11 U.S.C. § 362(k).

Dated this 15th day of August, 2018, at New Haven, Connecticut.

Ann M. Nevins
United States Bankruptcy Judge
District of Connecticut

Sec. 52-552i. Defenses, liability and protection of transferee. (a) A transfer or obligation is not voidable under subdivision (1) of subsection (a) of section 52-552e against a person who took in good faith and for a reasonably equivalent value.

(b) Except as otherwise provided in this section, to the extent a transfer is voidable in an action by a creditor under subdivision (1) of subsection (a) of section 52-552h, the creditor may recover judgment for the value of the asset transferred, as adjusted under subsection (d) of this section, or the amount necessary to satisfy the creditor's claim, whichever is less. The judgment may be entered against: (1) The first transferee of the asset or the person for whose benefit the transfer was made, or (2) any subsequent transferee other than a good-faith transferee who took for value or from any subsequent transferee.

(c) If the judgment under subsection (b) of this section is based upon the value of the asset transferred, the judgment must be for an amount equal to the value of the asset at the time of the transfer, subject to adjustment as the equities may require.

(d) Notwithstanding voidability of a transfer or an obligation under sections 52-552a to 52-552*l*, inclusive, a good-faith transferee or obligee is entitled, to the extent of the value given the debtor for the transfer or obligation, to (1) a lien on or a right to retain any interest in the asset transferred; (2) enforcement of any obligation incurred; or (3) a reduction in the amount of the liability on the judgment.

(e) A transfer is not voidable under subdivision (2) of subsection (a) of section 52-552e or section 52-552f if the transfer results from termination of a lease upon default by the debtor when the termination is pursuant to the lease and applicable law.

(f) A transfer or obligation is not voidable under subdivision (2) of subsection (a) of section 52-552e or section 52-552f against an institution of higher education, as defined in 20 USC 1001, if the transfer was made or obligation incurred by a parent or guardian on behalf of a minor or adult child in furtherance of the child's undergraduate education.

(g) A transfer is not voidable under subsection (b) of section 52-552f: (1) To the extent the insider gave new value to or for the benefit of the debtor after the transfer was made unless the new value was secured by a valid lien, (2) if made in the ordinary course of business or financial affairs of the debtor and the insider, or (3) if made pursuant to a good-faith effort to rehabilitate the debtor and the transfer secured present value given for that purpose as well as an antecedent debt of the debtor.

(P.A. 91-297, S. 9; P.A. 17-50, S. 1.)

History: P.A. 17-50 added new Subsec. (f) re transfer or obligation not voidable against an institution of higher education, and redesignated existing Subsec. (f) as Subsec. (g).

Plain language of section demonstrates that Uniform Fraudulent Transfer Act was enacted specifically to expand range of a creditor's remedies beyond the common-law property and proceeds rule. 266 C. 1.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT
HARTFORD DIVISION

In re: ANLINDA Y. KNIGHT, Debtor.	:	CASE No. 15-21646 (JJT) CHAPTER 7
THOMAS C. BOSCARINO, CHAPTER 7 TRUSTEE OF THE ESTATE OF ANLINDA Y. KNIGHT, Plaintiff. v. BOARD OF TRUSTEES OF CONNECTICUT STATE UNIVERSITY SYSTEM, Defendant.	:	ADV. PRO. No. 15-02064 (JJT) RE: ECF Nos. 30, 34, 35, 36

APPEARANCES

Jeffrey Hellman, Esq. Law Offices of Jeffrey Hellman, LLC 195 Church Street, 10th Floor New Haven, CT 06510	Attorney for the Chapter 7 Trustee
Denise S. Mondell, Esq. Assistant Attorney General 55 Elm St., Fourth Floor Hartford, CT 06141-0120	Attorney for the Board of Trustees

MEMORANDUM OPINION ON DEFENDANT'S
MOTION FOR SUMMARY JUDGMENT

In this adversary proceeding, Thomas C. Boscarino, the Chapter 7 Trustee (the "Trustee") of the estate of Alinda Y. Knight (the "Debtor" or "Ms. Knight") seeks to avoid and recover, as fraudulent transfers pursuant to both 11 U.S.C. § 548(a)(1)(B) and Conn. Gen. Stat. §§ 52-552e(a)(2) and f(a) ("CUFTA"), several payments that Ms. Knight made for her adult son's college tuition and expenses. Before the Court is the motion for summary judgment (the "Motion") of the Defendant in this adversary proceeding, the Board of Trustees of Connecticut State University System (the "Board"), which seeks judgment in its favor on both counts of the complaint. For the reasons stated herein, the Court denies the Motion in its entirety.

JURISDICTION

The Court has subject matter jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334(b). This adversary proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). Venue is proper in the Bankruptcy Court pursuant to 28 U.S.C. § 1409(a). This action is brought as an adversary proceeding pursuant to Federal Rule of Bankruptcy Procedure 7001. [1]

FACTUAL BACKGROUND

The facts in this case are essentially undisputed. On September 18, 2015 (the "Petition Date"), the Debtor filed a petition for relief under Chapter 7 of the United States Bankruptcy Code. The Debtor is the mother of Jeremy G. Thomas ("Jeremy"), who was born on November 10, 1993.

Jeremy was enrolled as a full-time undergraduate student at Central Connecticut State University ("CCSU") during the period from the Fall of 2011 through the Spring of 2016. Pursuant to Conn. Gen. Stat. § 10a-87, the Board of Trustees of the Connecticut State University System shall maintain CCSU.

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[1] For ease of reference, Federal Rules of Bankruptcy Procedure are referred to as Fed. R. Bank. P. and Federal Rules of Civil Procedure are referred to as Fed. R. Civ. P..

Although the Debtor made payments to CCSU in October of 2011, the Trustee is not seeking to recover any payments made by the Debtor to CCSU before Jeremy reached the age of eighteen. Between November 28, 2011 and September 18, 2013, the Debtor paid $16,527.00 to CCSU for Jeremy's tuition and related educational expenses (the "Initial Transfers"). Between September 18, 2013 and the Petition Date, the Debtor paid CCSU $5,509.50 for Jeremy's tuition and expenses (the "Subsequent Transfers", and together with the "Initial Transfers", the "Transfers").

As averred in her uncontested affidavit, the Debtor made the payments to CSSU because she wanted to reduce the amount of debt that Jeremy would graduate with and because she wanted to fulfill her Expected Family Contribution, a federally-imposed formula that is applied in determining a student's eligibility for federal financial aid. The Debtor also believed that subsidizing Jeremy's college tuition would help Jeremy become financially self-sufficient, which, in turn, would ultimately result in a financial benefit to her because Jeremy would be less likely to rely upon her for housing, food and other costs and more likely to be in a position someday to provide financial support to her, if necessary.

ANALYSIS

A. Summary Judgment Standard

Fed. R. Bank. P. 7056 makes Fed. R. Civ. P. 56 applicable to adversary proceedings in bankruptcy. Fed. R. Civ. P. 56(a) provides that summary judgment shall enter only if "the movant shows there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law."

The burden rests with the moving party to clearly establish the absence of a genuine issue as to any material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322–23, 331, 106 S. Ct. 2548, 2552–53, 91 L. Ed. 2d 265 (1986); *Adickes v. S.H. Dress & Co.*, 398 U.S. 144, 157, 90 S.Ct. 1598, 1608, 26 L. Ed. 2d 142 (1970). Regardless of whether the material facts are undisputed, however, "the court must determine whether the legal theory of the motion is sound." *Jackson v. Fed. Exp.*, 766 F.3d 189, 194 (2d Cir. 2014).

B. The Evidence Establishes That The Debtor Did Not Receive Reasonably Equivalent Value In Exchange For The Transfers

Section 548(a)(1)(B) of the Bankruptcy Code, the 'constructive fraud' provision, states, in pertinent part, as follows:

> (a)(1) The trustee may avoid any transfer…of an interest of the debtor in property…that was made...on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily--
>
> (B)(i) received less than a reasonably equivalent value in exchange for such transfer…; and
>
> (ii)(I) was insolvent on the date that such transfer was made…or became insolvent as a result of such transfer…;

11 U.S.C. § 548(a)(1)(B). As the party seeking to avoid the transaction, the Trustee bears the burden to establish every element of a voidable transfer under section 548, including the absence of reasonably equivalent value, by a preponderance of the evidence. *In re S.W. Bach & Co.*, 435 B.R. 866, 875 (Bankr. S.D.N.Y. 2010).

For purposes of the Motion, the Board assumes that the Debtor was insolvent at the time of the Transfers or became so as a result of the Transfers. The parties therefore agree that the Transfers would qualify as constructively fraudulent under both 11 U.S.C. § 548(a)(1)(B) and Conn. Gen. Stat. §§ 52-552e(a)(2) and f(a), if the Trustee could establish that the Debtor received less than reasonably equivalent value in exchange for the Transfers.[2]

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[2] The Court will not address Conn. Gen. Stat. §§ 52-552e(a)(2) and f(a) independently, as "[t]he Section 52–552d(b) concept of "reasonably equivalent value" [under CUFTA] is identical to the Section 548(a)(1)(B) concept of

As explained below, the Court finds that the Debtor did not receive any legally cognizable value under these statutes in exchange for the Transfers and therefore could not have received reasonably equivalent value.

To determine whether a debtor received "reasonably equivalent value" in exchange for a transfer, courts first determine whether the debtor received any "value" at all in exchange for the transfer, and then determine whether the value received was reasonably equivalent to the value the debtor gave up. *In re Lyondell Chem. Co.*, 567 B.R. 55, 113–14 (Bankr. S.D.N.Y. 2017); *Kipperman v. Onex Corp.*, 411 B.R. 805, 837 (N.D. Ga. 2009); *In re Adler, Coleman Clearing Corp.*, 263 B.R. 406, 466–67 (S.D.N.Y. 2001); *see also Mellon Bank v. Official Comm. of Unsecured Creditors (In re R.M.L., Inc.)*, 92 F.3d 139, 149 (3d Cir. 1996) ("[B]efore determining whether the value was 'reasonably equivalent' to what the debtor gave up, the court must make an express factual determination as to whether the debtor received any value at all.").

The Bankruptcy Code defines "value," for purposes of section 548, as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but [it] does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor." 11 U.S.C. § 548(d)(2)(A). Under this definition, value is limited to economic benefits that preserve the net worth of the debtor's estate for the benefit of creditors. *Rubin v. Manufacturers Hanover Tr. Co.*, 661 F.2d 979, 992 (2d Cir. 1981) (applying the Bankruptcy Act) ("The decisions in fact turn on the statutory purpose of conserving the debtor's estate for the benefit of creditors."); *Suhar v. Bruno*, 541 F. App'x 609, 611–12 (6th Cir. 2013) ("[W]e look to the net effect of the transfer or obligation on the debtor's estate and, more specifically, on the remaining funds available to the unsecured creditors."); *Warfield v. Byron*, 436 F.3d 551, 560 (5th Cir. 2006) ("The primary

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'reasonably equivalent value'." *In re Fitzgerald*, 255 B.R. 807, 810 (Bankr. D. Conn. 2000). The parties have not asserted otherwise.

consideration in analyzing the exchange of value for any transfer is the degree to which the transferor's net worth is preserved."); *Harman v. First Am. Bank of Md. (In re Jeffrey Bigelow Design Group, Inc.)*, 956 F.2d 479, 485 (4th Cir. 1992) ("[T]he focus is whether the net effect of the transaction has depleted the bankruptcy estate."); *see also HBE Leasing Corp. v. Frank*, 48 F.3d 623, 638–39 (2d Cir. 1995) (To determine whether a debtor indirectly received reasonably equivalent value, "the fact-finder must first attempt to measure the economic benefit that the debtor indirectly received from the entire transaction, and then compare that benefit to the value of the property the debtor transferred."); *Lisle v. John Wiley & Sons, Inc. (In re Wilkinson)*, 196 F. App'x 337, 342 (6th Cir. 2006) ("Value can be in the form of either a direct economic benefit or an indirect economic benefit."); *Zubrod v. Kelsey (In Re Kelsey)*, 270 B.R. 776, 781 (9th Cir. BAP 2001) ("value is limited to economic or monetary consideration"); *In re R.M.L.*, 92 F.3d at 149 ("The touchstone is whether the transaction conferred realizable commercial value on the debtor ….") (citations omitted).

Moral or familial obligations cannot be considered in the value analysis "for the obvious reason that the depletion of resources available to creditors cannot be offset by the satisfaction of moral obligations." *Coan v. Fleet Credit Card Servs.*, 225 B.R. 32, 37 (Bankr. D. Conn. 1998). "As cold and unsentimental as that rule might seem, it is easier to understand from the perspective of creditors, most of whom would probably be unwilling to volunteer to provide a financial subsidy to enhance the insolvent debtor's family relationships by allowing the debtor to put valuable property beyond their reach." *Zeddun v. Griswold, (In re Wierzbicki)*, 830 F.3d 683, 689-90 (7th Cir. 2016) citing *In re Bargfrede*, 117 F.3d 1078, 1080 (8th Cir. 1997) ("[N]on-economic benefits in the form of a release of a possible burden on the marital relationship and the preservation of the family relationship" cannot confer reasonably equivalent value under section 548 because they are "sufficiently analogous to other intangible, psychological benefits".); *In re Treadwell*, 699 F.2d 1050, 1051 (11th Cir. 1983) (Love and affection do not constitute "reasonably equivalent value" under section 548.).

Far from a novel principle, this rule traces its roots to one of the first fraudulent conveyance acts, the Statute of 13 Elizabeth, which was codified under English law in 1571. The Statute, also referred to as the Fraudulent Conveyance Act of 1571, "made it fraudulent to hide assets from creditors by giving them to one's family, friends, or associates." *Husky Int'l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1587, 194 L. Ed. 2d 655 (2016). To hold otherwise would violate the bedrock common law principle, "be just before you are generous," which undergirds the Code's 'constructive fraud' provision, § 548(a)(1)(B). *See Boston Trading Grp., Inc. v. Burnazos*, 835 F.2d 1504, 1508 (1st Cir. 1987) (Breyer, J.); *In re Bloch*, 207 B.R. 944, 947 (D. Colo. 1997).

Indeed, carving out an exception for transfers that satisfied intangible social obligations would also violate the plain language of the Bankruptcy Code. Whereas the definition of value under section 548 includes "satisfaction . . . of a . . . debt of the debtor," 11 U.S.C. § 548(d)(2)(A), the Code defines "debt" as "liability on a claim," and "claim" refers to a right to payment or to an equitable remedy for breach of performance. 11 U.S.C. § 101(5), (12). These definitions plainly exclude intangible debts, whether they take the form of moral, familial or even spiritual obligations. *See Morris v. Midway Southern Baptist Church (In re Newman)*, 203 B.R. 468, 473–74 (D. Kan. 1996).

Accordingly, several courts have held that parents do not receive reasonably equivalent value in exchange for college tuition payments made on behalf of their adult children because any benefit received by parents is not economic, concrete or quantifiable. *See Roach v. Skidmore*

Coll. (Matter of Dunston), 566 B.R. 624, 636-37 (Bankr. S.D. Ga. 2017); *Gold v. Marquette Univ. (In re Leonard)*, 454 B.R. 444, 457 (Bankr. E.D. Mich. 2011); *Banner v. Lindsay* (*In re Lindsay*), Adversary No. 08–9091 (CGM), 2010 WL 1780065, at *9 (Bankr. S.D.N.Y. May 4, 2010). From this view, parents who pay their child's college tuition do not receive any legally cognizable value, much less reasonably equivalent value, in exchange for such payments. *See In re Leonard*, 454 B.R. at 457 (parents received no value for college tuition payments made on behalf of their adult child because they had no legal obligation to pay); *see also Barbour v. Barbour*, 156 Conn. App. 383, 400, 113 A.3d 77, 87 (2015) ("As a general matter, [t]he obligation of a parent to support a child terminates when the child attains the age of majority, which, in this state, is eighteen.").

Notwithstanding the law's clear and settled pronouncement that "value" does not include satisfaction of intangible debts, a few courts have rejected efforts by trustees to recover parents' tuition payments for their children on the theory that such payments fulfill a parent's social obligation to maintain their family unit. *See, e.g.*, *Trizechahn Gateway, LLC v. Oberdick* (*In re Oberdick*), 490 B.R. 687, 712 (Bankr. W.D.Pa. 2013) (Even though parents have no legal obligation to assist in financing their children's undergraduate education "there is something of a societal expectation that parents will assist with such expense if they are able to do so."); *Sikirica v. Cohen (In re Cohen)*, Adversary No. 07–02517–JAD, 2012 WL 5360956 at *10 (Bankr. W.D.Pa. Oct. 31, 2012), *rev'd in part on other grounds*, 487 B.R. 615 (W.D.Pa. 2013) (payment of undergraduate tuition for adult child discharges parent's social obligation and therefore confers reasonably equivalent value; however, parent's social obligation to pay for adult child's higher education does not extend to financing child's graduate school tuition); *Eisenberg v. Penn*

State Univ. (In re Lewis), Adversary No. 16-0282, 2017 WL 1344622 (Bankr. E.D. Pa. Apr. 7, 2017) (adopting *Oberdick* and *Cohen*).

To be sure, this Court credits concerns about familial obligations and the wisdom of allowing trustees to claw back parents' college tuition payments for their adult children. But, in our constitutional system, the separation of powers dictates that even well-founded concerns of the judiciary must yield to the clear intent of Congress:

> Our individual appraisal of the wisdom or unwisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting a statute. Once the meaning of an enactment is discerned and its constitutionality determined, the judicial process comes to an end.
>
> * * *
>
> [I]n our constitutional system the commitment to the separation of powers is too fundamental for us to pre-empt congressional action by judicially decreeing what accords with 'common sense and the public weal.' Our Constitution vests such responsibilities in the political branches.

TVA v. Hill, 437 U.S. 153, 194-95, 98 S. Ct. 2279, 2302, 57 L. Ed. 2d 117 (1978). Congress may someday amend the Bankruptcy Code to achieve the result reached in *Oberdick* and *Cohen* "but it is not for us to speculate, much less act, on whether Congress would have altered its stance had the specific events of this case been anticipated." *Kelly v. Robinson,* 479 U.S. 36, 58, 107 S. Ct. 353, 365, 93 L. Ed. 2d 216 (1986) (internal quotation omitted).

We have been here before. Not long ago, courts across the country divided over whether tithes and other donations to religious institutions were recoverable as constructively fraudulent transfers, given the absence of economic value that parishioners received in exchange for their donations. *Compare In re Bloch*, 207 B.R. 944, 948 (D. Colo. 1997) (tithe was recoverable, as no economic value was received in exchange) *with In re Moses*, 59 B.R. 815, 818 (Bankr. N.D.Ga.

1986) (holding that tithe was not recoverable, as church services constituted value within meaning of section 548).

In response, Congress passed the Religious Liberty and Charitable Donation Protection Act of 1998, Pub. L. No. 105-183 §§ 2, 3(a), June 19, 1998, 112 Stat. 517 (the "Donation Protection Act"). The Donation Protection Act amended section 548 to expressly shield "charitable contribution[s] to a qualified religious or charitable entity" from avoidance, provided that "the amount of that contribution does not exceed 15 percent of the gross annual income of the debtor for the year in which the transfer of the contribution is made" or "was consistent with the practices of the debtor in making charitable contributions." *See id.*

This measured formula reflects a sensible, yet necessarily arbitrary, balancing between a debtor's social obligations and their obligations to creditors that only Congress can achieve[3]:

> The responsibilities for assessing the wisdom of such policy choices and resolving the struggle between competing views of the public interest are not judicial ones: 'Our Constitution vests such responsibilities in the political branches.'

Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 866, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984) *quoting TVA v. Hill*, 437 U.S. 153, 195, 98 S.Ct. 2279, 57 L.Ed.2d 117 (1978)). Courts can no more discern whether society expects parents to cut off their tuition payments once children reach graduate school than they can divine a precise percentage

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[3] In its wisdom, the Connecticut General Assembly has amended Conn. Gen. Stat. § 52-552i to expressly shield tuition payments from recovery, effective October 1, 2017:

> (f) A transfer or obligation is not voidable under subdivision (2) of subsection (a) of section 52-552e or section 52-552f against an institution of higher education, as defined in 20 USC 1001, if the transfer was made or obligation incurred by a parent or guardian on behalf of a minor or adult child in furtherance of the child's undergraduate education.

An Act Revising the Uniform Fraudulent Transfer Act, 2017 Conn. Legis. Serv. P.A. 17-50 (S.B. 1021). The law does not have retroactive effect, and the parties agree that it has no application in this case.

delimiting the amount of money debtors should be permitted to donate to charity. This Court is no exception.

Accordingly, the Court rejects the Board's assertion that the Debtor received "value" by discharging her familial obligation to pay a portion of Jeremy's tuition and expenses at CCSU. While such support is unquestionably admirable and may have helped fulfill her Expected Family Contribution under the federal financial aid regime, it is undisputed that the Debtor had no legal obligation pay for her adult son's college education. The Transfers did not, therefore, satisfy "a present or antecedent debt of the debtor" or otherwise confer "value" to the Debtor within the meaning of 11 U.S.C. § 548(d)(2)(A). *See Matter of Dunston*, 566 B.R. at 637; *see also In re Globe Tanker Servs. Inc.*, 151 B.R. 23, 24–25 (Bankr. D. Conn. 1993) ("[T]ransfers made or obligations incurred solely for the benefit of third parties do not furnish reasonably equivalent value.").

The Board's reliance upon *DeGiacomo v. Sacred Heart University, Inc.*, (*In re Palladino)*, 556 B.R. 10 (Bankr. D. Mass. 2016) for the proposition that the Debtor received an indirect economic benefit in exchange for the Transfers is equally unavailing. In *Palladino*, the court conceded that "value" must be economic in nature yet held that the debtor parents therein received an indirect economic benefit in exchange for paying their adult daughter's undergraduate tuition that was reasonably equivalent to their tuition payments:

> I find that the [parents] paid [Sacred Heart University] because they believed that a financially self-sufficient daughter offered them an economic benefit and that a college degree would directly contribute to financial self-sufficiency. I find that motivation to be concrete and quantifiable enough. The operative standard used in both the Bankruptcy Code and the UFTA is "reasonably equivalent value." The emphasis should be on "reasonably." Often a parent will not know at the time she pays a bill, whether for herself or for her child, if the medical procedure, the music lesson, or the college fee will turn out to have been "worth it." But future outcome cannot be the standard for determining whether one receives reasonably equivalent value at the time of a payment. A parent can reasonably assume that

> paying for a child to obtain an undergraduate degree will enhance the financial well-being of the child which in turn will confer an economic benefit on the parent. This, it seems to me, constitutes a *quid pro quo* that is reasonable and reasonable equivalence is all that is required.

In re Palladino, 556 B.R. at 16.

Respectfully, this Court disagrees. It may be reasonable for parents to believe that investment in their child's college education will enhance the financial well-being of the child. It may also be reasonable for parents to assume that their child will someday reimburse them for the cost of tuition or otherwise confer an economic benefit in return. Piling one plausible inference upon another, however, is little more than wishful thinking. Moreover, such speculation about another's ability to repay in the future and their willingness to do so, however reasonable, does not amount to a *quid pro quo* and certainly does not provide economic value to current creditors.

The absence of a *quid pro quo* is itself fatal under section 548(a)(1)(B). *In re Adler, Coleman Clearing Corp.*, 263 B.R. 406, 466–67 (S.D.N.Y. 2001) ("[T]he statute requires that the debtor must have 'received' the value in question 'in exchange' for the transfer or obligation at stake."). Even if a child promised to repay their parent's tuition outlays in the future, "[a]n unperformed promise to pay or to deliver securities in the future, after the debtor has completed the transfer or incurred the obligation, cannot satisfy the concept of a fair exchange." *Id.* ("Under § 548(d)(2)(A), the term "value" would exclude future considerations, at least to the extent they remain unperformed.").

Finally, it is, of course, true that future outcome cannot be the touchstone for whether a debtor received value, reasonably equivalent or otherwise, at the time of payment. *Palladino*, 556 B.R. at 10; *In re Adler*, 263 B.R. at 467 ("The requirement that the debtor must have 'received' the value in question expresses a temporal condition demanding an element of contemporaneity in the determination of whether something close to the reasonable equivalence has been exchanged.”). Indeed, as the Board points out, courts have concluded that a “mere expectation” of economic benefit “would suffice to confer ‘value’ so long as the expectation was ‘*legitimate and reasonable*.’” *In re R.M.L., Inc.*, 92 F.3d 139, 152 (3d Cir. 1996), quoting *Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 647 (3d Cir.1991), *cert. denied*, 503 U.S. 937, 112 S.Ct. 1476, 117 L.Ed.2d 620 (1992). Under *R.M.L.* and its progeny, however, value is only conferred if “there is some chance that a contemplated investment will generate a positive return at the time of the disputed transfer”. *Id.*

In this case, the Debtor could not have had a “legitimate and reasonable” expectation of economic benefit, much less expect to generate a positive return at the time, from transfers that conveyed thousands of dollars for her son’s college tuition, without even a vague promise that funds would be repaid in the future. *See In re MarketXT Holdings Corp.*, 376 B.R. 390, 414 (Bankr. S.D.N.Y. 2007) (“The [d]ebtor could not have had a ‘legitimate and reasonable’ expectation of benefit” from transfer of significant assets “in return for a vague, speculative promise, never performed . . . .”).

The Defendant’s motion for summary judgment is denied. The parties will be directed to appear and confer with regard to the terms of a final pretrial order.

IT IS SO ORDERED at Hartford, Connecticut this 29th day of September 2017.

James J. Tancredi
United States Bankruptcy Judge
District of Connecticut

In re: BRUCE STERMAN and LUBA PINCUS, Debtors.

ROBERT GELTZER, as Chapter 7 Trustee of BRUCE STERMAN and LUBA PINCUS Plaintiff,
v.
OBERLIN COLLEGE, OBERLIN STUDENT COOPERATIVE ASSOCIATION, NELNET, INC., ALEXANDRA STERMAN, and SAMANTHA STERMAN, Defendants.

Case No. 16-10378 (MG)
Adv. Pro. Case No. 18-01015 (MG)

UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK

December 4, 2018

FOR PUBLICATION

MEMORANDUM OPINION AND ORDER GRANTING IN PART AND DENYING IN PART CROSS-MOTIONS FOR SUMMARY JUDGMENT

APPEARANCES:

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MARTIN GLENN UNITED STATES BANKRUPTCY JUDGE

The Chapter 7 Trustee, Robert L. Geltzer (the "Trustee"), seeks to recover as constructive fraudulent transfers amounts paid by the Chapter 7 co-debtors, Luba Pincus and Bruce Sterman (the "Debtors"), to or for the benefit of their two daughters, defendants Alexandra Sterman and Samantha Sterman (the "Defendants"), allegedly for college tuition, books and supplies, and room and board while they were students at Oberlin College. The Trustee and the Defendants filed cross-motions for summary judgment (the "Trustee's Motion," ECF Doc. # 24; the "Defendants' Motion," ECF Doc. # 22 at 11). The Defendants' Motion is supported by the affidavits of debtor Luba Pincus (the "Pincus Affidavit," ECF Doc. # 22 at 1) and debtor Bruce Sterman (the "Sterman Affidavit," ECF Doc. # 22 at 5).

The parties also entered a stipulation of undisputed facts (the "Stipulated Facts," ECF Doc. # 21). The Stipulated Facts indicate that some of the transfers to or for the benefit of Samantha were made while she was a college student *before* she was 21 years old and some were made while she was a college student *after* she was 21 years old. The Stipulated Facts indicate that the transfers to or for the benefit of Alexandra were made *after* she was 21 years old and *had already graduated from college*. According to the Stipulated Facts, since Alexandra graduated college in 2009, she has been "financially independent." (Stipulated Facts ¶ 15.)

The parties limit their cross motions to a request that the Court rule whether the Debtors received "reasonably equivalent value" for the transfers for college tuition and expenses; if the Debtors received reasonably equivalent value, the transfers would not be avoidable as constructive fraudulent transfers even if the Debtors were insolvent at the time of the transfers. There are two questions presented: first, did the Debtors receive reasonably equivalent value for their daughters' college educations and related expenses because their daughters' education will

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enhance their self-sufficiency; and second, does it matter whether the daughters were younger or older than 21 when the transfers were made?

For the reasons explained below, the Court grants the Trustee's Motion in part and denies it in part with respect to the transfers to or for the benefit of Samantha. The Trustee's Motion is granted with respect to the transfers to or for the benefit of Alexandra, as she was older than 21 and no longer a student when the transfers were made.

I. BACKGROUND

The Debtors, Luba Pincus and Bruce Sterman, filed a joint chapter 7 petition on February 19, 2016 (the "Petition Date"). (The Stipulated Facts ¶ 2.) The Trustee filed an adversary proceeding to recover allegedly constructively fraudulent transfers made by the Debtors to or for the benefit of their daughters. (*Id.* ¶ 11-12.)[1]

Alexandra attended Oberlin College from 2005-2009; Samantha attended Oberlin College from 2009-2013. (*Id.* ¶ 15-19.) In the six years prior to the Petition Date, the Debtors made several transfers to or for the benefit of their daughters. The parties stipulate that the transfers were made in connection with the Defendants' "college educations at Oberlin College and related expenses, including school books and supplies, meals, campus housing/rent/utilities, transportation and birthday presents." (*Id.* ¶ 12.)

The Stipulated Facts state that Alexandra Sterman reached age 21 on January 12, 2008 and graduated from Oberlin College in 2009. (Stipulated Facts ¶¶ 13 & 14.) Exhibit A to the Complaint (ECF Doc. # 1) indicates that transfers to or for the benefit of Alexandra, totaling

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$15,675.00, were made between August 13, 2010 and October 13, 2015. Paragraph 12 of the Stipulated Facts states that "[t]he schedules of transfers that are attached to the Complaint as Exhibits A and B accurately describe the transfers to and/or for the benefit of the Defendants that are the subject of the Complaint." Those two exhibits list transfers between 2010-2015. Both the Stipulated Facts and the Pincus Affidavit state that Alexandra attended college between 2005 and 2009, and graduated in 2009, so it is clear under the Stipulated Facts that the transfers to or for the benefit of Alexandra all were made after she was 21 years old and after she graduated from Oberlin. The Pincus Affidavit also makes clear that "[s]ince graduation [Alexandra] has been fully employed, self sufficient and tax paying adult." (Pincus Affidavit ¶ 9.)

The Trustee claims that the transfers are constructively fraudulent. The Trustee seeks to recover $15,675.00 from Alexandra for transfers "while she was of majority age." (Stipulated Facts ¶ 16.) The Trustee seeks to recover $9,952.00 from Samantha; $2,276.00 of those transfers were made "in respect of college tuition and living expenses . . . while she was a minor, and $7,676.00 were made while she was of majority age."[2] (*Id.* ¶ 18.)

For purposes of the summary judgment motions, "the parties have agreed not to put solvency at issue." (Trustee's Motion ¶ 12, ECF Doc. # 11.) Therefore, the sole question is whether the Debtors received reasonably equivalent value for the transfers to or for the benefit of their daughters.[3]

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II. LEGAL STANDARD

A. Summary Judgment

Rule 56(a) of the Federal Rules of Civil Procedure, made applicable by Bankruptcy Rule 7056, states that "[t]he court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(a). To successfully assert that a fact is not in dispute or cannot be disputed, a movant must:

> cit[e] to particular parts of materials in the record, including depositions, documents, electronically stored information, affidavits or declarations, stipulations (including those made for purposes of the motion only), admissions, interrogatory answers, or other materials; or show[] that the material cited do not establish the absence or presence of a genuine dispute, or that an adverse party cannot produce admissible evidence to support the fact.

FED. R. CIV. P. § 56(c)(1).

"The party seeking summary judgment bears the burden of establishing that no genuine issue of material fact exists and that the undisputed facts establish [the movant's] right to judgment as a matter of law." *In re Soliman*, 515 B.R. 179, 185 (Bankr. S.D.N.Y. 2014), (citing *Rodriguez v. City of New York*, 72 F.3d 1051, 1060-61 (2d Cir. 1995)).

B. Fraudulent Transfers

The Trustee claims that the transfers were constructively fraudulent pursuant to Bankruptcy Code § 544. Section 544 provides that the trustee may avoid a transfer of a debtor's property interest that is voidable under state law by a creditor holding an allowed unsecured claim. *See* 11 U.S.C. § 544(b)(1); *see also Banner v. Lindsay (In re Lindsay)*, Adv. Proc. No. 08-9091, 2010 WL 1780065, at *5 (Bankr. S.D.N.Y. 2010). The Trustee alleges that the transfers in question were fraudulent under the New York Debtor and Creditor Law ("NYDCL").

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Under the NYDCL, a conveyance is fraudulent if it is incurred without "fair consideration." NYDCL §§ 273 and 275. "Fair consideration" is defined by the NYDCL as follows:

> fair consideration is given for property, or obligation, a. When in exchange for such property, or obligation, as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied, or b. When such property, or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property, or obligation obtained.

NYDCL § 272.

Ordinarily, the plaintiff bears the burden of proving a lack of fair consideration but where, as here, "the facts regarding the nature of the consideration are within the transferee's control, the burden of proving the fairness of consideration shifts to the transferee." *Ackerman v. Ventimiglia (In re Ventimiglia)*, 362 B.R. 71 (Bankr. E.D.N.Y. 2007).

The Trustee also argues that the conveyances were constructively fraudulent under Bankruptcy Code § 548. Under that provision, a trustee may avoid a transfer made by the debtor within two years of the filing of the petition if the debtor did not receive "reasonably equivalent value" in the exchange. 11 U.S.C. § 548(a)(1)(b). The Bankruptcy Code defines the term "value" as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor." 11 U.S.C.A. § 548(d)(2)(A). The Bankruptcy Code does not define the term "reasonably equivalent value." *In re Gonzalez*, 342 B.R. 165, 169 (Bankr. S.D.N.Y. 2006). Courts have found that the term does not require the exchange to be "mathematically equal" but "[p]urely emotional benefits, such as love and affection" will not suffice. *Id.* at 169, 173. Both direct and indirect benefits flowing to the debtor may be considered. *In re Akanmu*, 502 B.R.

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124, 130-31 (Bankr. E.D.N.Y. 2013) (quoting *Liquidation Trust v. Daimler AG (In re Old CarCo LLC)*, No. 11 Civ. 5039(DLC), 2011 WL 5865193, at *7 (S.D.N.Y. Nov. 22, 2011)). "Fair consideration" under the NYDCL and "reasonably equivalent value" under section 548(a)(1)(B)(i) have substantially the same meaning. *Id.* (citing *Picard v. Madoff (In re Bernard L. Madoff Inv. Sec. LLC)*, 458 B.R. 87, 110 (Bankr.S.D.N.Y.2011)).[4]

III. DISCUSSION

The conveyances in this case must be broken down into three categories: (A) transfers made for education-related expenses to or for the benefit of both daughters after they reached the age of majority so that they could attend Oberlin College,[5] (B) transfers made for education-related expenses to or for the benefit of Samantha when she was a minor, and (C) transfers to Alexandra after she graduated from college. Summary judgment should be granted to the Trustee with respect to categories (A) and (C) and denied with respect to category (B). Summary judgment should be denied to Alexandra and Samantha with respect to category (A) and (C) and granted to Samantha with respect to category (B).[6]

A. The Education Related Transfers Made after the Defendants Reached the Age of Majority

There is a developing body of law regarding whether college tuition payments made by parents for the education of their children after they reach the age of majority are constructively

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fraudulent. The Trustee points to several decisions where courts held that pre-petition college tuition payments are avoidable because the debtor parents did not receive reasonably equivalent value in exchange for the tuition payments. *See Boscarino v. Bd. of Trs. of Conn. State Univ. Sys. (In re Knight)*, 2017 WL 4410455 (Bankr. D. Conn. 2017); *Roach v. Skidmore Coll. (Matter of Dunston)*, 566 B.R. 624, 636-37 (Bankr. S.D. Ga. 2017); *Gold v. Marquette Univ. (In re Leonard)*, 454 B.R. 444 (Bankr. E.D. Mich. 2011); *Lindsay*, 2010 WL 1780065. The Defendants counter by pointing to case law holding that parents did receive reasonably equivalent value in exchange for college tuition payments. *See Lewis v. Penn. St. Univ. (In re Lewis)*, 574 B.R. 536, 541 (Bankr. E.D. Pa. 2017); *DeGiacomo v. Sacred Heart Univ., Inc. (In re Palladino)*, 556 B.R. 10, 16 (Bankr. D. Mass. 2016); *Trizechahn Gateway, LLC v. Oberdick (In re Oberdick)*, 490 B.R. 687, 712 (Bankr. W. D. Pa. 2013); *Sikirica v. Cohen (In re Cohen)*, 2012 WL 5360956, at *10 (Bankr. W. D. Pa. 2012).[7]

Whether insolvent parents receive reasonably equivalent value for college tuition payments made for the benefit of their adult children is a culturally and socially charged issue. With the greatest respect for the courts that have found reasonably equivalent value for such tuition payments, the Court is constrained by the language of the Bankruptcy Code and the NYDCL—those statutes define the terms "value" and "fair consideration" to require either the transfer of property or the satisfaction of an antecedent debt in return for an insolvent debtor's payments. 11 U.S.C.A. § 548(d)(2)(A); NYDCL § 272. The Debtors received neither in this

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case with respect to transfers made to or for the benefit of Alexandra and Samantha after they reached the age of majority—21 years old in New York State.[8]

Alexandra and Samantha argue that their parents received reasonably equivalent value because the transfers made after they were adults increased the likelihood that they would be self-sufficient. (Pincus Affidavit ¶ 23.) The Massachusetts bankruptcy court reached that conclusion in *In re Palladino*, 556 B.R. at 16. In that case, the debtors made pre-petition tuition payments so that their daughter could attend college. *Id.* at 12. The Trustee attempted to set aside the tuition payments on a theory of constructive fraud. *Id.* at 13. The court ruled against the trustee because it found that the parents received an economic benefit from the tuition payments. The court stated:

> I find that the [debtors] paid [the college] because they believed that a financially self-sufficient daughter offered them an economic benefit and that a college degree would directly contribute to financial self-sufficiency . . . A parent can reasonably assume that paying for a child to obtain an undergraduate degree will enhance the financial well-being of the child which in turn will confer an economic benefit on the parent. This, it seems to me, constitutes a *quid pro quo* that is reasonable and reasonable equivalence is all that is required.

Id. at 16.

The court's conclusion is supported by studies on the value of a college education to a family. *See* Brief *Amici Curiae* of American Council on Education, and 19 Other Education Associations in Support of Sacred Heart University, Inc. and Affirmance, at 4-7, *Degiacomo v.*

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Sacred Heart University, No. 17-1334 (1st Cir. Jul. 27, 2017) (citing studies showing that a college degree improves an individual's chances of gaining employment, increases their average income, and decreases the chances that they will live with their parents).

The Court does not question whether the Debtors' decision to send money to or for the benefit of their adult daughters for their college education was economically prudent. But, unfortunately, the economic "benefit" identified by the Defendants does not constitute "value" under the NYDCL or the Bankruptcy Code.

In *In re Lindsay*, 2010 WL 1780065, Judge Morris ordered avoidance, as constructively fraudulent transfers, of college tuition payments made for the benefit of the debtors' son. It is unclear whether the tuition payments were made before or after the son turned 21. The opinion only refers to the "adult son" living with his parents. *Id.* at 1. The court rejected the defendants' argument that a legal obligation to pay the tuition existed.[9] The defendants argued that they had a legal and moral obligation to pay for their child's education. *Id.* at *9. But the defendants did not point to any authority supporting these arguments. *Id.* ("The Court is not aware of any law requiring a parent to pay for a child's college education. Defendants do not offer any authority in support of their argument that a judgment debtor's 'moral obligation' to pay for a child's college education is a defense to [the NYDCL]."). To the extent that *Lindsay* is read to require avoidance for tuition and education-related expenses for adult children, this Court agrees with the decision. *See also Knight*, 2017 WL 4410455, at *5 ("While such support is unquestionably

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admirable . . . it is undisputed that the Debtor had no legal obligation [to] pay for her adult son's college education.").[10]

The Defendants here also argue that the Debtors received "psychic and other intangible benefits" from the conveyances. (Defendants' Opposition Brief, at 12.) The Defendants explain:

> The debtors benefited when they paid rent by knowing their daughters had a roof over their heads on campus. The debtors benefited when they paid utilities by knowing their daughters has [sic] heat and light to read their books on campus. The debtors benefited when they paid health insurance by knowing their daughters could receive medical care. The debtors benefitted when they paid for transportation to and from Oberlin by knowing their daughters were travelling safely to and from campus.

(*Id.* at 11.) The Defendants support this argument by citing to *In re Gonzalez*, 342 B.R. 165. In that case, the debtor had a son out of wedlock with a woman named Karen. *Id.* at 167. Although he had no legal obligation to do so, the debtor made regular monthly payments on a mortgage for the home where his son and Karen lived. *Id.* The debtor claimed "that he made the payments to support his son . . . and because Karen was unable to keep current on the note and could not otherwise provide a proper home for [their son]." *Id.* The debtor spent "all of his weekends" at the home with Karen and his son. *Id.* at 167. The trustee argued that the mortgage payments made by the debtor were avoidable because they were constructively fraudulent. *Id.* at 168. The court ruled against the trustee. The Defendants correctly point out that the *Gonzalez* court's ruling was based in part because the debtor received "psychic" and "other intangible benefits" from the mortgage payments. *Id.* at 172. The Defendants ignore, however, that the court found that these benefits were "in addition to" the debtors' use of the property on a weekly basis. *Id.*

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Thus, *Gonzalez* does not stand for the proposition that "psychic" benefits alone constitute reasonably equivalent value, as the Defendants portend.

Accordingly, the Trustee's summary judgment motion with respect to the transfers made after Alexandra and Samantha reached the age of 21 is granted.

B. Education Related Conveyances before Samantha Reached the Age of Majority

The Stipulated Facts indicate that $2,276.00 of the transfers to or for the benefit of Samantha were made while she was a minor. (Stipulated Facts ¶ 18.) The Stipulated Facts also state that the transfers were made for her "college education[ ] at Oberlin College and related expenses, including school books and supplies, meals, campus housing/rent/utilities, transportation and birthday presents." (*Id.* ¶ 12.) While the case law does not *require* that parents pay for college tuition for a minor child at a private college to satisfy the parents' obligation to provide a minor child with education, the issue rather is whether the parents receive reasonably equivalent value when they do pay for such an education. On this issue, the Court agrees with Chief Judge Craig, writing in *In re Akkanmu:*

> The Trustee argues that New York law does not require the Debtors to provide parochial or private school education, and that the Debtors could have satisfied their obligation at no cost by sending the children to public school. This argument misses the point. The fact that the Debtors chose to educate their children in parochial school rather than public school, arguably exceeding the "minimum standard of care," does not change the fact that, by doing so, they satisfied their legal obligation to educate their children, thereby receiving reasonably equivalent value and fair consideration. It is irrelevant to this determination whether the Debtors could have spent less on the children's education, or, for that matter, on their clothing, food, or shelter. To hold otherwise would permit a trustee to scrutinize debtors' expenditures for their children's benefit, and seek to recover from the vendor if, in the trustee's judgment, the expenditure was not reasonably necessary, or if the good or service could have been obtained at a lower price, or at no cost, elsewhere. For example, a trustee could seek to avoid a debtor's payments to a restaurant for a meal purchased for the debtor's child, or payments

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> to a department store for clothing purchased for the child, on a theory that adequate food or clothing could have been obtained at lower cost. A trustee could sue the vendor to recover the cost of a computer or other electronic device purchased pre-petition by a debtor for his child, on the theory that the item was not reasonably necessary. . . . . The absurdity of this scenario is obvious.
>
> A trustee is not granted veto power over a debtor's personal decisions, at least with respect to pre-petition expenditures. "[A] trustee's powers are not limitless." *In re Thompson*, 253 B.R. 823, 825 (Bankr. N.D. Ohio 2000). "[T]he 'Bankruptcy Code confers absolutely no power upon the trustee to make decisions concerning how a debtor manages his everyday affairs such as where the debtor will live or work.'" *French v. Miller (In re Miller)*, 247 B.R. 704, 709 (Bankr. N.D. Ohio 2000) (determining whether a chapter 7 trustee may waive the attorney-client privilege of a debtor). This is equally applicable to a debtor's decisions concerning where and how to educate his children.

In re Akanmu, 502 B.R. at 132-33; *Graves v. Graves*, 675 N.Y.S.2d 843, 846-47 (Sup. Ct. 1998) (requiring father to pay for child's college education).

Therefore, barring facts showing egregious conduct by debtors (which has not been shown here with respect to these Debtors),[11] the Court concludes that Samantha is entitled to summary judgment dismissing the portion of the Trustee's claim seeking to recover $2,276.00 of the transfers to or for the benefit of Samantha made while she was a minor; the Trustee's cross motion to recover this portion of the transfers is denied.

C. Transfers to Alexandra After She Graduated from College

The Court has already concluded in Section A above that the Debtors did not receive reasonably equivalent value in return for the transfers made to or for the benefit of Alexandra and Samantha after they were 21. The Stipulated Facts show that all the transfers to or for the benefit of Alexandra were *after* she graduated college, *after* she reached the age of 21, and *after*

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she was financially independent. Even if any argument could support paying college tuition and related expenses for an adult child while still in school, if the student started college while still a minor, no argument has been made that would immunize from avoidance transfers made after graduation once the adult child has become financially independent.

IV. **CONCLUSION**

For the reasons explained above, the Court concludes that transfers to or for the benefit of Alexandra and Samantha after they reached the age of 21 for college tuition and related expenses are avoidable as constructive fraudulent transfers if the Debtors were insolvent at the times the transfers were made. On the other hand, on the record before the Court, transfers to or for the benefit of Samantha while she was a minor for college tuition and related expenses were supported by reasonably equivalent value and, therefore, are not avoidable.

IT IS SO ORDERED.

Dated: December 4, 2018
New York, New York

/s/__________
MARTIN GLENN
United States Bankruptcy Judge

Footnotes:

[1.] The Complaint also seeks to recover conveyances made to Oberlin College, Oberlin Student Cooperative Association, Navient Corporation, and Nelnet, Inc. The Trustee entered into a stipulation dismissing the Complaint against Nelnet, Inc. on September 24, 2018 (ECF Doc. # 30), and has since reached settlement agreements with Oberlin College, Oberlin Student Cooperative Association, and Navient Corporation. (ECF Doc. # 31-33.) Accordingly, the only remaining defendants are Alexandra and Samantha Sterman.

[2.] Settled New York law recognizes parents' obligation to provide minor children with housing, food, education and healthcare. "[I]t is axiomatic that parents are obligated to provide for their children's necessities, such as food, clothing, shelter, medical care, and education." *In re Michel*, 572 B.R. 463, 475 (Bankr. E.D.N.Y. 2017) (quoting *In re Akanmu*, 502 B.R. 124, 132 (Bankr. E.D.N.Y. 2013). The age of majority in New York is 21 years old. *Columbia Cty. Dep't of Soc. Servs. ex rel. William O v. Richard O*, 262 A.D.2d 913, 914, 692 N.Y.S.2d 496, 498 (1999) ("As a general rule, parents are required to support a child until the child attains the age of 21 (*see*, Family Ct Act § 413 [1][a]).").

[3.] The Complaint also includes a claim for unjust enrichment. (Complaint ¶¶ 45-49.)

The parties' summary judgment papers are silent on the unjust enrichment claim and only consider whether the conveyances were constructively fraudulent. Accordingly, the unjust enrichment claim is not presently before the Court.

4. Both section 548 of the Bankruptcy Code and the NYDCL require that the trustee establish that the Debtors were insolvent when the transfers were made. Whether the Debtors were insolvent at the times of the transfers remains unresolved.

5. All the challenged transfers to or for the benefit of Alexandra were made *after* reached the age of majority (21) and *after* she graduated from college in 2009, and while she was working and "financially independent." It is unclear how these transfers after Alexandra graduated were made so that Alexandra could attend Oberlin College from which she had already graduated. In any event, as explained below, the Court concludes that the Debtors did not receive reasonably equivalent value for transfers made to or for the benefit of Alexandra or Samantha after they reached the age of 21.

6. The Complaint also seeks to recover $700 in cash gifts to Alexandra and Samantha. The Stipulated Facts do not provide any details about those gifts. Nothing in this Opinion addresses the issues concerning the cash gifts.

7. The recent decision by the district court in *Pergament v. Brooklyn Law School*, 18-CV-2204 (ARR), 2018 WL 6182502 (E.D.N.Y. November 27, 2018), is inapposite. The court reversed the bankruptcy court's grant of summary judgment on constructive fraudulent transfer claims in favor of three universities that received tuition payments from a chapter 7 debtor for two of his children. The issue addressed by the district court was whether the colleges were initial transferees, or subsequent transferees that took the tuition payments in good faith. The issue whether the debtor received reasonably equivalent value for the tuition payments is not addressed.

8. State law determines the age of majority. It defines the age below which parents are required to provide financial support for their children. The State law requirement to provide financial support establishes the antecedent debt that is satisfied by the payment for tuition and related expenses. As already indicated, New York law sets the age of majority at 21. *See supra* n.3. *In re Knight*, 2017 WL 4410455, one of the best reasoned decisions concluding that tuition payments for adult children does not provide reasonably equivalent value arose from transfers for college tuition for a child over 18 years of age in Connecticut. Unlike New York which defines the age of majority as 21, Connecticut defines the age of majority as 18. *See Spencer v. Spencer*, 10 N.Y.3d 60, 63 (2008).

9. *In re Lindsay*, No. 06-36352 (CGM), 2010 WL 1780065, at *9 (Bankr. S.D.N.Y. May 4, 2010) ("Defendants admit that they transferred proceeds of certain assets sales to a university for their son's education. The Court notes at the outset that Defendants produce no evidence of their alleged legal obligation to pay their son's tuition, such as a promissory note in favor of the university or a lender. The Court is not aware of any law requiring a parent to pay for a child's college education.").

10. To the extent that *Lindsay* is read to require avoidance for tuition and education-related expenses for adult children, I agree with the decision. As explained in the next section of this Opinion, however, I reach a different result for transfers for tuition and education-related expenses for minor children, which I conclude may be supported by reasonably equivalent value.

11. One could postulate egregious facts—such as a distressed debtor making a lump sum transfer of several years of tuition

payments and expected related expenses before filing a bankruptcy case—that could lead a court to conclude that the transfer is avoidable as an actual or constructive fraudulent transfer.

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586 B.R. 88

IN RE: Katalin DEMITRUS, Debtor.

Anthony S. Novak, Chapter 7 Trustee, Plaintiff
v.
University of Miami, Defendant.

CASE No. 15–22081 (JJT)
ADV. PRO. No. 17–02036 (JJT)

United States Bankruptcy Court, D. Connecticut, Hartford Division.

Signed February 27, 2018

[586 B.R. 89]

Jeffrey Hellman, Esq., Law Offices of Jeffrey Hellman, LLC, New Haven, CT, Counsel for the Plaintiff

Ilan Markus, Esq., Daniel P. Elliott, Esq., LeClairRyan, P.C., New Haven, CT, Counsel for the Defendant

MEMORANDUM OF DECISION ON DEFENDANT's MOTION TO DISMISS

RE: ECF No. 19, 24, 25

James J. Tancredi, United States Bankruptcy Judge

I. INTRODUCTION

Pending before this Court is a Motion to Dismiss (ECF No. 19) filed by the Defendant, University of Miami ("Defendant" or "University"), the Memorandum of Law in Opposition to the Motion to Dismiss ("Opposition", ECF No. 24), filed by the Plaintiff, the Chapter 7 Trustee ("Trustee"), and the related Reply Brief (ECF No. 25). For the reasons stated herein, the Court grants the Motion to Dismiss.

II. JURISDICTION

This Court has jurisdiction under 28 U.S.C. §§ 157 and 1334(b) and may hear and determine this matter on reference from the District Court pursuant to 28 U.S.C. §§ 157(a) and (b)(1). This is a core

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proceeding pursuant to 28 U.S.C. §§ 157(b)(2)(A), (B), (E), (H) and (O). The parties herein have consented to this Court's jurisdiction to enter final orders in this Adversary Proceeding. *See* ECF Nos. 30 and 31.

III. FACTUAL BACKGROUND

On December 1, 2015, the Debtor, Katalin Demitrus, filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. On July 19, 2017, the Trustee initiated this Adversary Proceeding against the University and asserted the following causes of action: (1) Constructive Fraudulent Transfer, pursuant to 11 U.S.C. §§ 548(a)(1)(B), 550 and 551 ; and (2) UFTA Constructive Fraudulent Transfer, pursuant to 11 U.S.C. § 544(b)(1) and Conn. Gen. Stat. §§ 52–552e(a)(2) and 52–552f(a) ("CUFTA"). On November 28, 2017, the Trustee filed the instant Amended Complaint which, with the exception of one paragraph, is a mirror image of the original Complaint.

On December 7, 2017, the University filed the Motion to Dismiss and accompanying Memorandum of Law. On January 12, 2018, the Trustee filed the Opposition. On January 19, 2018, the University filed a reply. On February 12, 2018, both parties appeared and presented oral arguments before the Court. Following the hearing, the matter was taken under advisement.

In his Complaint, the Trustee alleges that the Debtor is the parent of Alexander N. Demitrus who, at all relevant times, was over the age of 18 years.[1] He alleges that between September of 2013 to October of 2014, when

Alexander was a student at the University, the Debtor made a number of transfers to the University by means of a Federal Direct Parent PLUS loan ("Parent PLUS Loan") to pay for Alexander's tuition. The Trustee claims that these payments constitute constructive fraudulent transfers, pursuant to the Bankruptcy Code and CUFTA. He seeks that the total of $66,616.00 be avoided and/or set aside and recovered for the benefit of the Debtor's estate.

IV. LEGAL STANDARD

Rule 12(b)(6) of the Federal Rules of Civil Procedure, made applicable herein by Rule 7012(b) of the Federal Rules of Bankruptcy Procedure, permits a party to move to dismiss a case for "failure to state a claim upon which relief can be granted." The Supreme Court has stated, "[t]o survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim for relief that is plausible on its face." *Ashcroft v. Iqbal* , 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting *Bell Atlantic Corp. v. Twombly* , 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). A claim is facially plausible "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal* , 556 U.S. at 678, 129 S.Ct. 1937 (citing *Twombly* , 550 U.S. at 556, 127 S.Ct. 1955). A pleading that offers, "labels and conclusions or a formulaic recitation of the elements of a cause of action will not do." *Iqbal* , 556 U.S. at 678, 129 S.Ct. 1937 (quoting *Twombly* , 550 U.S. at 555, 127 S.Ct. 1955). "Nor does a complaint suffice if it tenders naked assertion[s] devoid of further factual enhancement." *Iqbal* , 556 U.S. at 678, 129 S.Ct. 1937 (quoting *Twombly* , 550 U.S. at 557, 127 S.Ct. 1955) (internal quotations omitted). Instead, a plaintiff

[586 B.R. 91]

must provide enough factual support that, if true, would "raise a right to relief above the speculative level." *Twombly* , 550 U.S. at 555, 127 S.Ct. 1955.

Rule 12(b)(6) of the Federal Rules of Civil Procedure allows the court to eliminate actions that are fatally flawed in their legal premise and destined to fail, and thus "streamlines litigation by dispensing with needless discovery and factfinding." *See Neitzke v. Williams* , 490 U.S. 319, 326–27, 109 S.Ct. 1827, 104 L.Ed.2d 338 (1989) ("[I]f as a matter of law it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations, a claim must be dismissed, without regard to whether it is based on an outlandish legal theory or on a close but ultimately unavailing one") (internal citation and quotations omitted).

V. DISCUSSION

Under Section 548 of the Bankruptcy Code, a transfer may only be avoided under Section 548 if, *inter alia* , the transferred funds constituted "an interest of the debtor in property."[2] Likewise, a transfer may only be avoided under Section 544 and CUFTA if, *inter alia* , the transferred funds constitute "an asset or an interest in an asset of the Debtors."[3] The federal and state standards for "property" and "asset" are substantively equivalent.

The Trustee alleges that the "transfers" here consisted of the Parent PLUS Loan payments by the Debtor to the University. Compl. at ¶¶ 14; 23. Whether the Parent PLUS Loan payments constitute property or assets of the Debtor is generally determined by applicable nonbankruptcy law, "unless some federal interest requires a different result." *Butner v. U.S.* , 440 U.S. 48, 55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979) ; *see also Official Committee of Unsecured Creditors v. PSS Steamship Co., Inc. (In re Prudential Lines, Inc.)* , 928 F.2d 565, 569 (2d Cir. 1991) ("The nature and extent of the debtor's interest in property is determined by applicable non-bankruptcy law") (citations omitted).

Parent PLUS Loans are governed by a clear federal statutory program: the Higher Education Act of 1965 (20 U.S.C. § 1001 *et seq.*) (the "HEA"), as well as its implementing regulations (34 C.F.R. § 685.100 *et seq.*) (the "Regulations"). The Direct PLUS Loan program was established by Congress for the purpose of allowing eligible parents to enable their dependent children to pursue their courses of

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study in college. *See* 20 U.S.C. § 1087a(a). Under the Regulations, only "[a]n eligible parent" may borrow under the Direct PLUS Loan program. *See* 34 C.F.R. § 685.101. Parent PLUS Loans may only be issued "to pay for the student's cost of attendance ..." at "[c]olleges, universities, graduate and professional schools, vocational schools, and proprietary schools ..." *See* 34 C.F.R. § 685.101(a). "A parent is eligible" if "[t]he parent is borrowing to pay for the educational costs of a dependent undergraduate student ..." *See* 34 C.F.R. § 685.200(c)(2)(i). The amount of a Parent PLUS Loan is determined based on financial information of the borrowers, the rate of tuition and other costs of attendance at the university; the amount that may be borrowed cannot exceed the amount of tuition and other authorized educational expenses, and the Parent PLUS Loan can only be used for tuition and other qualified educational expenses. *See* 34 C.F.R. § 682.204(g) and (j).

Under 20 U.S.C. § 1078–2(c), "All loans made under this section shall be ... disbursed by: (1) an electronic transfer of funds from the lender to the eligible institution; or (2) a check copayable to the eligible institution and the graduate or professional student or parent borrower." If a student withdraws from the university, transfers to another university, or otherwise loses his eligibility for the loan, the university is required to pay any refund of tuition to the Department of Education ("DOE") or transfer the funds to the institution to which the student transferred. *See* 34 C.F.R. § 682.607. The HEA permits the DOE to take enforcement action seeking criminal penalties against any person who obtains PLUS loan funds by fraud or who misapplies such funds. *See* 20 U.S.C. § 1097(a). The criminal penalties include fines of up to $20,000.00 and imprisonment for up to 5 years, or both. *Id.*

Here, in regard to the "transfers", the Complaint only alleges that funds were disbursed to the University "by means of a Direct Parent PLUS loan." Compl. at ¶ 14. The HEA and its Regulations make abundantly clear that the funds allegedly disbursed to the University could not possibly have been the Debtor's property, nor could those funds have ever been within the reach of creditors.

In examining the issues raised by the Motion to Dismiss, the Court is persuaded that a recent decision, *Eisenberg v. Pennsylvania State University (In re Lewis)* , 574 B.R. 536 (Bankr. E.D. Pa. 2017) (Fehling, J.) is dispositive on the issue of whether the proceeds of a Parent PLUS Loan constitute property of the debtor available for the benefit of creditors.[4] In that case, a Chapter 7 trustee commenced an adversary proceeding against Penn State University seeking the recovery of Parent PLUS Loan proceeds paid to the university. The trustee asserted fraudulent transfer claims pursuant to Section 548, as well as state law. The court dismissed the case on the pleadings, beginning by classifying the trustee's argument as "a relatively new legal theory." *Id.* at 537. After acknowledging the trustee's burden to prove that the transferred funds constituted property of the debtor, the court held:

> "[T]he proceeds from the Parent PLUS loans were never [the debtor's] property, were never

> in his possession or control, and were never remotely available to pay [the debtor's] creditors. As a result, the [DOE's] payment of the Parent

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> PLUS loan proceeds to Penn State did not diminish [the debtor's] bankruptcy estate and avoidance of these transfers would be improper and unwarranted."

Id. at 539.

After extensively reviewing and citing to the relevant portions of the HEA and the Regulations, set forth above, the court further held:

> "As evidenced by the [HEA] and the regulations promulgated thereunder, the funds represented by the Parent PLUS loans at issue would never have come into existence had [the debtor's] children not attended Penn State. The proceeds of the Parent PLUS loans at issue did not and could not have passed through [the debtor's] hands and did not and could not have been used to pay any of [the debtor's] debt and could not be used for any other purpose than to pay the cost of the children's tuition and other qualified educational expenses at Penn State."

Id. at 540. The court continued:

> The Parent PLUS loan proceeds were never in [the debtor's] possession or control, could not ever be in [the debtor's] possession or control, and therefore could not possibly be considered to be property of the estate ...
>
> For all of these reasons, I find that applicable nonbankruptcy law (*i.e.,* the [HEA] and the Regulations promulgated thereunder), expressly prevented the Parent PLUS loan proceeds from becoming property of [the debtor] or his estate. In addition, the Parent PLUS proceeds were not and could not have been property in which [the debtor] had an interest or over which he had control. None of the Parent PLUS proceeds could have been available in any circumstance to pay [the debtor's] creditors. Because [the debtor] never had possession of, control over, or an interest in, the Parent PLUS loan proceeds, those proceeds could not have been available to pay [the debtor's creditors].
>
> Permitting the trustee to proceed with this litigation would enable fraudulent transfer avoidance statutes to be used improperly as revenue generating tools. Such usage would do nothing to further the fundamental premise underlying both the Bankruptcy Code and PUFTA fraudulent transfer provisions, which is ‘to prevent a debtor from putting assets otherwise available to its creditors out of their reach ... and to prevent the unjust diminution of the debtor's estate.’

Id. Judge Fehling accordingly dismissed the trustee's complaint.

Similarly, in *Shapiro v. Gideon (In re Gideon)* , Case No. 15–50464, Adv. Pro. No. 16–4939 (TJT) (Bankr. E.D. Mich. Apr. 26, 2017) (Tucker, J.), the court entered summary judgment against the Chapter 7 trustee in an adversary proceeding also seeking recovery of Parent PLUS Loan proceeds from DePaul University, pursuant to a fraudulent transfer theory.[5] The court found that the proceeds of Parent PLUS Loans simply could not constitute property of the debtor that was available for the benefit of creditors. In granting summary judgment, Judge Tucker held:

> [T]he evidence is clear and undisputed that at no time did the loan proceeds—did these loan proceeds go into a bank account of the bankruptcy debtor ... nor did they go in any way through his

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> hands or ... to his possession. He never had possession of the loan funds.... [S]o it certainly appears from all of that that while the bankruptcy debtor ... did incur an obligation as ... the borrower on these PLUS loans and quite arguably incurred an obligation that might be avoidable as a ... fraudulent obligation because the debtor ... may not have received reasonably equivalent value for the obligation he incurred on these loans ... avoidance of the obligation that [the debtor] incurred is not what the trustee seeks in this adversary proceeding. That's clear from the complaint and the argument on ... this motion. It is, rather, avoidance of the transfer and recovery of the funds—the loan funds—that were transferred from the Department of Education to DePaul under the PLUS loans at issue. Those are the transfers alleged in the trustee's complaint and it's clear the trustee is seeking avoidance of those transfers, and not avoidance of any obligation that the debtor ... incurred in connection with those loans ... [U]nder the undisputed facts, material facts here that are relevant to the issue, the record clearly shows, and there can be no genuine dispute here—that the loan funds at issue that were transferred to DePaul were not property of the debtor ...[6]

The clear consensus forming in the courts on this issue is reflective of the purpose underlying the trustee's avoidance powers, namely, to prevent the depletion of assets that otherwise would have been available to creditors.[7] Requiring that transfers subject to avoidance could have been available to creditors comports with the spirit and purpose of fraudulent transfer provisions in the Bankruptcy Code and CUFTA, *i.e.* , "to protect creditors by preventing a debtor from placing assets otherwise available to pay creditors out of reach of those creditors." *See Eisenberg* , 574 B.R. at 539 (citations omitted) (discussing federal and comparable Pennsylvania law). That purpose is not frustrated where, as here, the Debtor never exercised dominion or control over the funds, and the transfer of the funds did not diminish the Debtor's estate. *See In re Kennedy* , 279 B.R. 455, 460 (Bankr. D. Conn. 2002).

Ultimately, the Trustee has failed to allege, and, given the federal statutory and regulatory scheme regulating DOE loans[8] , is without the ability to demonstrate

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the requisite interest to support his avoidance claims under applicable non-bankruptcy law. Therefore, as a matter of law, the Complaint fails to state a claim upon which relief can be granted.

Accordingly, this Motion to Dismiss is GRANTED and judgment shall enter in favor of the Defendant.[9]

IT IS SO ORDERED at Hartford, Connecticut this 27th day of February 2018.

Notes:

[1] In Connecticut, any person over the age of 18 years is considered an adult. *See* Conn. Gen. Stat. § 1–1d.

[2] *See* 11 U.S.C. § 548(a)(1)(B)(i) ("The trustee may avoid any transfer ... *of an interest of the debtor in property* , or any obligation ... incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily ... received less than a reasonably equivalent value in exchange for such transfer or obligation.") (emphasis added).

[3] *See* 11 U.S.C. § 544(b)(1) ("[T]he trustee may avoid any transfer *of an interest of the debtor in property* or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of the title") (emphasis added); Conn. Gen. Stat. §§ 52–552e(a)(2) and 52–552f(a) ("A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, if the creditor's claim arose before the transfer was made or the obligation was incurred and if the debtor made the transfer or incurred the obligation ... (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation."). Pursuant to Conn. Gen. Stat. § 52–552b(12), " '[t]ransfer' means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with *an asset or an interest in an asset* ." (emphasis added).

[4] This Court has respectfully declined to follow Judge Fehling's analysis regarding reasonably equivalent value. *See Thomas C. Boscarino Ch. 7 Trustee v. Board of Trustees of Connecticut State University System (In re Knight)* Ch. 7 Case No. 15–21646, Adv. Pro. No. 15-02064 (JJT), 2017 WL 4410455, at *1 (Bankr. D. Conn. 2017).

[5] Judge Tucker did not issue a written memorandum of decision, but rather explained the reasoning behind his decision on the record of a April 26, 2017 hearing. *See Shapiro v. Gideon (In re Gideon)* , No. 16–04939 (TJT) (Bankr. E.D. Mich. Apr. 26, 2017), ECF No. 34; *See also* Transcript of Oral Argument attached to the Mot. to Dismiss at Tab B.

[6] Mot. to Dismiss at Tab B pp. 15–16.

[7] *See, e.g., Frontier Bank v. Brown (In re Northern Merchandise, Inc.)* , 371 F.3d 1056, 1060 (9th Cir. 2004) ("[Section 548] seeks to prevent the debtor from depleting the resources available to creditors through gratuitous transfers of the debtor's property ...") (citation and quotations omitted); *R2 Advisors, LLC v. Equitable Oil Purchasing Co. (In re Red Eagle Oil, Inc.)* , 567 B.R. 615, 626 (Bankr. D. Wyo. 2017) ("The Bankruptcy Code's fraudulent transfer statute means to protect creditors from transactions that are designed to, or have the effect, of unfairly draining the assets available to satisfy creditor claims or dilute legitimate creditor claims"); *Official Committee of Unsecured Creditors v. Sabine Oil & Gas Corp. (In re Sabine Oil & Gas Corp.)* , 562 B.R. 211, 225 (S.D.N.Y. 2016) ("In determining whether a conveyance is fraudulent, [t]he touchstone is the unjust diminution of the estate of the debtor that otherwise would be available to creditors") (citation omitted); *Ivey v. First*

Citizens Bank & Trust Co. , 539 B.R. 77, 83 (M.D.N.C. 2015) ("[t]he purpose of the Bankruptcy Code's avoidance provisions is to prevent a debtor from making transfers that diminish the bankruptcy estate to the detriment of creditors") (citation omitted); *Geltzer v. Xavieran High School (In re Akanmu)* , 502 B.R. 124, 130 (Bankr. E.D.N.Y. 2013) ("The purpose of [Section 548] is to set aside transactions that 'unfairly or improperly deplete a debtor's assets' so that the assets may be made available to creditors") (citation omitted).

[8] In construing two federal statutes, such as the HEA and the Bankruptcy Code, "statutes should be read consistently." *See Kremer v. Chem. Constr. Corp.* , 456 U.S. 461, 468, 102 S.Ct. 1883, 72 L.Ed.2d 262 (1982). As long as "two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *See FCC v. NextWave Pers. Commc'ns Inc* ., 537 U.S. 293, 304, 123 S.Ct. 832, 154 L.Ed.2d 863 (2003) (citation omitted).

[9] As the Court's ruling on this issue is dispositive, it need not reach the other issues raised in the Defendant's Motion to Dismiss.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT
NEW HAVEN DIVISION

In re: ROBERT R. DEMAURO JEAN M. DEMAURO *Debtors*	Case No.: 14-32312 (AMN) Chapter 7
GEORGE I. ROUMELIOTIS, CHAPTER 7 TRUSTEE FOR THE ESTATE OF ROBERT R. DEMAURO AND JEAN M. DEMAURO, *Plaintiff* v. JOHNSON & WALES UNIVERSITY, *Defendant*	Adv. Pro. No. 15-03011 (AMN) Re: ECF No. 72, 76

MEMORANDUM OF DECISION AND ORDER GRANTING JOHNSON & WALES UNIVERSITY'S MOTION FOR SUMMARY JUDGMENT

APPEARANCES

Jeffrey Hellman, Esq. Law Offices of Jeffrey Hellman, LLC 195 Church Street, 10th Floor New Haven, CT 06510	Counsel for the Plaintiff, George I. Roumeliotis, Chapter 7 Trustee
George W. Shuster, Esq. WilmerHale 7 World Trade Center 250 Greenwich Street New York, NY 10007	Counsel for the Defendant, Johnson & Wales University
Irve J. Goldman, Esq. Jessica Grossarth Kennedy Pullman & Comley, LLC 850 Main Street Bridgeport, CT 06601	Counsel for the Defendant, Johnson & Wales University

Before the court is a motion for summary judgment (the "Motion") filed by the defendant, Johnson & Wales University (the "University") seeking dismissal of the two-count complaint filed by the plaintiff, George Roumeliotis, the Chapter 7 Trustee ("Trustee") for the bankruptcy estate of Robert R. DeMauro and Jean M. DeMauro ("Mr. and Mrs. DeMauro"). AP-ECF No. 72.[1] In this adversary proceeding, the Trustee seeks to avoid and recover as constructive fraudulent transfers certain Federal Direct Parent PLUS Loan proceeds disbursed to the University for the tuition of Mr. and Mrs. DeMauro's adult daughter, Alyson DeMauro, pursuant to 11 U.S.C. §§ 544, 548 and 550. For the reasons that follow, the court concludes that the Direct PLUS Loan proceeds do not constitute an interest of the debtor in property subject to avoidance under 11 U.S.C. §§ 544 and 548 and, therefore, the summary judgment motion is granted.

I. <u>JURISDICTION</u>

This court has jurisdiction over this action pursuant to 28 U.S.C. §§ 1334(b) and 157(b), and the District Court's Order of referral of bankruptcy matters, dated September 21, 1984. This adversary proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(h) (proceedings to determine, avoid, or recover fraudulent conveyances). This adversary proceeding arises under the chapter 7 bankruptcy case pending in this District; therefore, venue is proper in this District pursuant to 28 U.S.C. § 1409.

II. <u>RELEVANT PROCEDURAL HISTORY</u>

On December 18, 2014, Mr. and Mrs. DeMauro filed a voluntary chapter 7 bankruptcy petition. ECF No. 1. Approximately four months later, on April 8, 2015, the Trustee initiated the instant adversary proceeding against the University. In Count One of the adversary proceeding complaint ("Complaint"), the Trustee seeks to avoid two payments allegedly made by Mr. and Mrs. DeMauro to the University – a December 4,

[1] Documents filed in the underlying chapter 7 case, bearing case number 14-32312, are identified as "ECF No. ___." Documents filed in this Adversary Proceeding are identified as "AP-ECF No. ___."

2012 payment and a March 12, 2013 payment, both in the amount of $8,754.00 -- as constructive fraudulent transfers and to recover the funds pursuant to 11 U.S.C. §§ 548(a)(1)(B), 550(a), and 551. AP-ECF No. 1. In Count Two of the Complaint, the Trustee seeks to avoid eight payments (collectively, the "Eight Payments")[2] allegedly made by Mr. and Mrs. DeMauro as constructive fraudulent transfers and to recover the funds pursuant to 11 U.S.C. § 544(b)(1) and the Connecticut Uniform Fraudulent Transfer Act ("CUFTA").[3] AP-ECF No. 1.

The University moved to dismiss the Complaint asserting the payments – all of which were Direct PLUS Loan proceeds -- were not property of Mr. and Mrs. DeMauro and not subject to § 548 because they were restricted funds disbursed under the Federal Direct PLUS Loan program. AP-ECF No. 8. The motion to dismiss also asserted that the allegation in Count One regarding a payment dated December 4, 2012 should be dismissed as it fell outside of the two year limitation period set forth in § 548(a). AP-ECF No. 8. Upon the agreement of the parties, the court (Manning, C.B.J.) struck the allegation in Count One regarding the December 4, 2012 payment.[4] AP-ECF No. 25. The court ordered, pursuant to Fed.R.Civ.P. 12(d), that the motion to dismiss be considered as a motion for summary judgment and ordered the parties to submit statements of fact in accordance with D. Conn. L.Civ.R. 56(a)(1) and (a)(2). AP-ECF No.

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[2] The eight payments included: a payment dated March 15, 2011 in the amount of $5,850.00; a payment dated September 13, 2011 in the amount of $2,535.00; a payment dated December 5, 2011 in the amount of $2,397.00; a payment dated December 6, 2011 in the amount of $4,932.00; a payment dated March 13, 2012 in the amount of $4,933.00; a payment dated September 11, 2012 in the amount of $8,754.00; a payment dated December 4, 2012 in the amount of $8,754.00; and a payment dated March 12, 2013 in the amount of $8,754.00. The December 4, 2012 payment and the March 12, 2013 payment are common to both Count One and Count Two.

[3] The Trustee specifically seeks relief pursuant to Conn. Gen. Stat. §§ 52-552e(a)(2), Conn. Gen. Stat. §§ 52-552f(a).

[4] The other payment in Count One – the March 12, 2013 payment – remained pending.

25. In addition to the parties submitting their respective statements of facts, the Association of Independent Colleges and Universities of Rhode Island, Association of Independent Colleges and Universities of Massachusetts and the Connecticut Conference of Independent Colleges filed an *amicus* brief in support of the University's motion to dismiss. ECF No. 37. At the conclusion of the hearing held on December 2, 2015, the court (Manning, C.B.J.) denied, without prejudice, the University's motion. ECF No. 43.

A little less than one year later, the University filed the present Motion seeking summary judgment as to Counts One and Two of the Complaint, arguing that 1) Mr. and Mrs. DeMauro did not have a property interest in the Federal Direct PLUS Loan proceeds and did not make the transfers; 2) the University was not the first or initial transferee and therefore is entitled to a "good faith" defense; and 3) Mr. and Mrs. DeMauro received reasonably equivalent value in exchange for the payments to the University. ECF No. 72. The Trustee objected and the court heard oral argument on June 22, 2017. *See* ECF Nos. 76, 77, 92.

III. <u>FACTUAL BACKGROUND</u>

The following material facts are undisputed:

1. Mr. and Mrs. DeMauro are the parents of Alyson DeMauro, an individual who at all relevant times has been over the age of eighteen. AP-ECF No. 1, ¶ 5; ECF No. 46, ¶ 5.
2. During the period from March 2011 through March 2013, Alyson DeMauro was a student at the University. AP-ECF No. 1, ¶ 6; AP-ECF No. 46, ¶ 6.

3. Each year Alyson DeMauro was enrolled at the University, Mr. DeMauro applied for and was approved by the United States Department of Education ("USDOE") for a Federal Direct PLUS Loan to help subsidize the cost of Alyson DeMauro's education at the University. AP-ECF No. 72-1, ¶ 3; AP-ECF No. 76-1, ¶ 3.
4. Federal Direct PLUS Loans were established pursuant to the Higher Education Act of 1965, as amended, 20 U.S.C. §§ 1001 *et seq.*, and related regulations, as amended, 34 C.F.R. § 682, governing PLUS loans. AP-ECF No. 39, ¶ 5; AP-ECF No. 41, ¶ 5.
5. In order for Mr. DeMauro to obtain a Federal Direct PLUS Loan, the USDOE required him to complete and sign a Direct PLUS Loan Master Promissory Note ("MPN"). AP-ECF No. 72-1, ¶¶ 4, 8; AP-ECF No. 76-1, ¶¶ 4, 8.
6. When Mr. DeMauro executed the MPN, he certified under penalty of perjury that the loan proceeds would be used for Alyson DeMauro's educational expenses, only. AP-ECF No. 72-1, ¶¶ 4, 8; AP-ECF No. 76-1, ¶¶ 4, 8.
7. From March 15, 2011 to March 12, 2013, the University received Eight Payments, totaling $46,909.00, directly from the USDOE as proceeds of Federal Direct PLUS Loans. AP-ECF No. 39, ¶¶ 1, 2, 5; AP-ECF No. 41, ¶¶ 1, 2, 5.
8. All of the payments referenced in the Complaint – including the March 12, 2013 payment referenced in ¶ 14 of Count One – were proceeds of Federal Direct PLUS Loans. AP-ECF No. 39, ¶¶ 3-5, AP-ECF No. 41, ¶¶ 5, and Counter-Statement pursuant to D.Conn.L.R. 56(a)(2), ¶ 1.

9. The University received the funds for the Eight Payments from the USDOE through a USDOE grant management portal known as "G5" (the "G5 Portal") AP-ECF No. 39, ¶¶ 1,2; AP-ECF No. 41, ¶¶ 1, 2.
10. The USDOE deposited the funds for the Eight Payments into the G5 Portal and the University could electronically withdraw the funds for the Eight Payments and transfer the Eight Payments into the University's checking account. AP-ECF No. 39, ¶ 2; AP-ECF No. 41, ¶ 2.
11. Neither Mr. nor Mrs. DeMauro held – either physically or in an account in their name - any of the funds for the Eight Payments prior to receipt of the funds by the University. AP-ECF No. 39, ¶¶ 3, 4; AP-ECF No. 41, ¶¶ 3, 4.

IV. <u>RELEVANT LAW</u>

The principles governing the court's review of a motion for summary judgment are well established. Summary judgment may be granted only if, "the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(a); Fed.R.Bankr.P. 7056. "In determining whether there is a genuine dispute as to a material fact, [the court] must resolve all ambiguities and draw all inferences against the moving party." *Hancock v. County of Rensselaer*, 882 F.3d 58, 64 (2d Cir. 2018)(*citing Marvel Characters, Inc. v. Kirby*, 726 F.3d 119 (2d Cir. 2013)). In essence, a "judge's function at summary judgment is not to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial." *Tolan v. Cotton*, 134 S. Ct. 1861, 1866 (2014)(internal citations and quotations omitted).

Section 548(a)(1)(B)(i) of the Bankruptcy Code permits a trustee to avoid a transfer of an interest of the debtor in property or any obligation incurred by a debtor that was made or incurred within two years before the date of the filing of the petition. 11 U.S.C. § 548(a)(1)(B)(i). As relevant to this decision, for a transfer to be avoidable, the debtor must have received less than "a reasonably equivalent value in exchange for such transfer or obligation" and the debtor must have been "insolvent on the date that such transfer was made" or "became insolvent as a result of such transfer or obligation." 11 U.S.C. § 548(a)(1)(B)(i) and (ii)(I). "Section 548 [] attempts to protect creditors from transactions which are designed, or have the effect, of unfairly draining the pool of assets available to satisfy creditors' claims." 5 *Collier on Bankruptcy* ¶ 548.01 (16th). "[N]ot all transfers are within § 548's scope; only those that affect property that would have been property of the estate but for the transfer." 5-548 *Collier on Bankruptcy* ¶ 548.03 (16th).

Section 550(a) authorizes a trustee to recover from the initial transferee of such transfer or the entity for whose benefit such transfer was made, the property transferred or the value of the property for the benefit of the estate to the extent the transfer is avoided under § 548. 11 U.S.C. § 550(a)(1).

Additionally, § 544(b)(1) provides a trustee with the power to "avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim ... ." 11 U.S.C. § 544(b)(1). Section 544(b) allows a trustee to "step into the shoes of a creditor under state law and avoid any transfers such a creditor could have avoided." *In re Tribune Co. Fraudulent Conveyance Litig.*, 818 F.3d 98, 113 (2d Cir. 2016)(*citing Universal Church v.*

Geltzer, 463 F.3d 218, 222 n. 1 (2d Cir. 2006)).[5] In this case, the state law invoked by the Trustee, under Count Two, is the Connecticut Uniform Fraudulent Transfer Act ("CUFTA"), specifically the provisions set forth in §§ 52-552e(a)(2) and 52-552f(a). AP-ECF No. 1. Conn. Gen. Stat. 52-552e(a)(2) and 52-552f(a) provide, in relevant part:

> A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, if the creditor's claim arose before the transfer was made or the obligation was incurred and if the debtor made the transfer or incurred the obligation … (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor … (B) intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they became due.
> Conn.Gen.Stat. § 52-552e(a)(2)(B).
>
> A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.
> Conn.Gen.Stat. § 52-552f(a).

Pursuant to Conn.Gen.Stat. § 52-552b(12), "[t]ransfer means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset." An "asset" for purposes of Conn.Gen.Stat. §§ 52-552e and 52-552f is generally defined as "property of a debtor". Conn.Gen.Stat. § 52-552b(2).

Similarly, in order for a transfer to be avoidable pursuant to § 548 of the Bankruptcy Code the transferred funds must constitute "an interest of the debtor in property." 11 U.S.C. § 548(a)(1). The definition of an interest is most often held to be the "equivalent

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[5] The goal of subsection (b) of § 544 is to maximize the estate and equalize the distribution of a debtor's assets among creditors of the same class. 5 *Collier on Bankruptcy* ¶ 544.01 (16th). Similar to § 548, a trustee cannot use section 544(b) if the threshold requirement that the debtor have an interest in property is not met. *Id*.

to property of the estate as defined in § 541(a)." 5 *Collier on Bankruptcy* ¶ 548.03 (16th). Pursuant to § 541(a), property of the bankruptcy estate consists of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). "[I]n determining the scope of § 541 [the court] must consider the purposes animating the Bankruptcy Code," which includes the intention to "bring anything of value that the debtors have into the estate." *Official Comm. Unsecured Creditors v. PSS Steamship Co. (In re Prudential Lines Inc.)*, 928 F.2d 565, 573 (2d Cir. 1991)(internal quotations and citations omitted). Generally, "property interests are created and defined by state law [] … [u]nless some federal interest requires a different result." *Butner v. United States*, 440 U.S. 48, 55 (1979); s*ee also Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 450–51 (2007) (reiterating the rule in *Butner*). Notwithstanding the enactment of the Bankruptcy Code in 1978, *Butner* remains good law.[6]

V. <u>DISCUSSION</u>

To avoid a transfer as a fraudulent transfer under either §§ 544, 548, or CUFTA, the Trustee must establish that Mr. DeMauro held an interest in the Direct PLUS Loan proceeds. The Trustee asserts that the court must apply state law to determine if Mr. DeMauro held an interest in the Direct PLUS Loan proceeds. The court disagrees. The existence of the Direct PLUS Loan Program, and the Direct PLUS Loan proceeds, is dependent upon and limited by the Higher Education Act of 1965, 20 U.S.C. §§ 1001 et seq. (the "HEA"). In *Butner*, the Supreme Court held that state law defines property interests "unless some federal interest requires a different result." *Butner*, 440 U.S. at 55.

[6] S*ee Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 450–51 (2007); *See also Stern v. Marshall*, 564 U.S. 462, 495 (2011).

Here, the countervailing federal interest – to safeguard the integrity of the Direct PLUS Loan Program – requires the application and review of federal law.

Subsequent to the enactment of the HEA, Congress established the Direct PLUS Loan Program to allow "eligible parents …to enable" their student children "to pursue their courses of study" in college. *See* 20 U.S.C. §§ 1078-2, 1087a; *See also* 34 C.F.R. § 685.100 *et seq*. Under the Direct PLUS Loan Program, the USDOE provides funds directly to an institution of higher education. 20 U.S.C. § 1087b. In the event an institution receives from the USDOE an amount that "exceeds the amount of assistance for which the student is eligible … the institution such student is attending shall withhold and return to the [USDOE] … the portion (or all) of such installment that exceeds such eligible amount." 20 U.S.C. § 1078-7(d)(2); *see also* 20 U.S.C. § 1091b.

The regulations promulgated by the USDOE relating to Direct PLUS Loans, include the following relevant provisions:

> A parent is eligible if "[t]he parent is borrowing to pay for the educational costs of a dependent undergraduate student."
> 34 C.F.R. § 685.200(c)(2)(i)
>
> The total amount of all Direct PLUS Loans that a parent … may borrow on behalf of each dependent student … for any academic year of study may not exceed the cost of attendance minus other estimated financial assistance for the student."
> 34 C.F.R. § 685.203(f)
>
> The borrower must give the school … as part of the origination process for a … Direct PLUS Loan: A statement, as described in 34 CFR part 668, that the loan will be used for the cost of the student's attendance
> 34 C.F.R. § 685.206(a)(1).

The HEA imposes a criminal penalty for the misuse of any funds received under the Direct PLUS Loan Program. *See* 20 U.S.C. § 1097(a)("Any person who knowingly and willfully embezzles, misapplies, steals, obtains by fraud, false statement, or forgery, or fails to refund any funds … provided … under this subchapter … shall be fined not more than $20,000 or imprisoned for not more than 5 years, or both.”).

When, as here, a court construes two federal statutes – the Bankruptcy Code and the HEA – the court is obligated to read the statutes consistently. “‘[W]hen two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective.’” *F.C.C. v. NextWave Pers. Communications Inc.*, 537 U.S. 293, 304 (2003) (*quoting J.E.M. AG Supply, Inc. v. Pioneer Hi–Bred International, Inc.*, 534 U.S. 124, 143–144 (2001)).

Here, the HEA and the Bankruptcy Code are capable of co-existence if the Direct PLUS Loan proceeds are not property of the debtor. Support of this proposition is found not only in the purpose of § 548 but additionally in the restrictions and limitations set forth in the Direct PLUS Loan Program. As noted previously, the purpose behind § 548 is to recover assets that – but for the transfer – would have been assets available for distribution to creditors. Meanwhile, the HEA’s – and specifically the Direct PLUS Loan Program’s - purpose is to provide parents with the opportunity to fund their dependent children’s secondary education. To protect this purpose, the regulations restrict the use of the Direct PLUS Loan proceeds to education expenses of the dependent child and expressly require that the funds be transmitted directly to the college or university, rather than to the parent-borrower. 20 U.S.C. § 1087b. Most importantly, § 1097(a) imposes a criminal penalty on the misuse of Direct PLUS Loan proceeds. This comprehensive statutory and regulatory scheme of the HEA indicates a clear intent by Congress to channel the Direct PLUS Loan proceeds to educational institutions to pay tuition, and to protect the proceeds from any misuse that might occur in the absence of the direct transfer to the educational institution.

A conclusion that the Direct PLUS Loan proceeds are property of the debtor for purposes of §§ 544 and 548 and therefore available for distribution to a debtor's creditors would undermine the purposes of the HEA and disregard the parent-debtor's lack of possession and control over the Direct PLUS Loan proceeds. The Third Circuit's approach in *The Majestic Star Casino, LLC v. Barden Development, Inc. (In re The Majestic Star Casino, LLC)*, 716 F.3d 736 (3rd Cir. 2013) is instructive on this point. In that case, the Third Circuit addressed whether a debtor's tax status – at the time of the petition - as a qualified subchapter S subsidiary ("QSub") constituted property of the estate pursuant to § 541. The Third Circuit examined the Internal Revenue Code's specific provisions pertaining to QSub status and noted that a debtor with QSub status did not possess an unrestricted right to the use, enjoyment, and disposition of that status, but that its QSub status was dependent on a number of factors outside of the debtor's control. *The Majestic Star Casino, LLC*, 716 F.3d at 758.

> Capacious as the definition of "property" may be in the bankruptcy context, we are convinced that it does not extend so far as to override rights statutorily granted to shareholders to control the tax status of the entity they own. "[T]he Code's property definition is not without limitations...." *Westmoreland*, 246 F.3d at 256. Even accepting that an interest that is "novel or contingent" may still represent property under the Code, *Segal*, 382 U.S. at 379, 86 S.Ct. 511, a tax classification over which the debtor has no control is not a "legal or equitable interest[ ] of the debtor in property" for purposes of § 541.
> *The Majestic Star Casino, LLC*, 716 F.3d at 757.

Here, Mr. DeMauro never possessed or held the Direct PLUS Loan proceeds prior to their being paid to the University. Additionally, Mr. DeMauro lacked any control over how the USDOE would disburse the proceeds. *See* 20 U.S.C. § 1087b. The Direct PLUS

Loan proceeds were restricted government funds issued to the University for the limited purpose of paying Alyson DeMauro's tuition and other qualified education-related expenses. Permitting Direct PLUS Loan proceeds to be used to pay non-educational expenses violates the provisions of the HEA and its corresponding regulations and runs counter to Congress's clear intention expressed in the criminal sanctions the debtor would be exposed to had he used the loan proceeds to pay his creditors.

Additionally, this court finds recent discussions by other courts persuasive including *Eisenberg v. Pennsylvania State University (In re Lewis)*, 574 B.R. 536 (Bankr. E.D. Pa. 2017) and *In re Demitrus*, No. 15-22081 (JJT), 2018 WL 1121589 (Bankr.D.Conn. February 27, 2018). In the *Eisenberg* case, the court noted that

> [T]he proceeds from the Parent Plus loans were never [the debtor's] property, were never in his possession or control, and were never remotely available to pay [the debtor's] creditors. As a result, the [USDOE's] payment of the Parent Plus loan proceeds to Penn State did not diminish [the debtor's] bankruptcy estate and avoidance of these transfers would be improper and unwarranted. *Eisenberg*, 574 B.R. at 539.

Here, as in *Eisenberg*, the debtor was never in possession or control of the Direct PLUS Loan proceeds and never controlled their use. The only control Mr. DeMauro possessed was whether or not to apply for the Direct PLUS Loan. After approval, the USDOE provided the funds for the Direct PLUS Loan and disbursed them directly to University. 20 U.S.C. § 1087b.

The Third Circuit, in *The Majestic Star Casino, LLC* decision, also noted that "[f]iling a bankruptcy petition is not supposed to expand or change a debtor's interest in an asset" *The Majestic Star Casino, LLC*, 716 F.3d at 760-761 (internal quotation omitted).

> But under the Bankruptcy Court's holding in this case, a QSub in bankruptcy can stymie legitimate transactions of its parent as unauthorized transfers of

> property of the estate, even though the QSub would have had no right to interfere with any of those transactions prior to the filing for bankruptcy.
> *The Majestic Star Casino, LLC*, 716 F.3d at 761.

Here, the Trustee has not cited any authority for the proposition that if the PLUS Loan proceeds are considered property of the debtor, and if the Trustee is allowed to avoid the transfer, that the Trustee could evade the statutes and regulations governing the PLUS Loan proceeds and disburse the proceeds to Mr. DeMauro's creditors. "A debtor may not increase its rights to property through the filing of a bankruptcy petition." *In re Bake-Line Group, LLC*, 359 B.R. 566, 570 (Bankr. D. Del. 2007)("541(a)(1) is not intended to expand the debtor's rights against others beyond what rights existed at the commencement of the case")(*citing* 5 *Collier on Bankruptcy* ¶ 541.04 (15th)); *See also* 5 *Collier on Bankruptcy* ¶ 541.03 (16th)("[a] trustee can assert no greater rights [in property] than the debtor had on the date the case was commenced."). If the transfer of the Direct PLUS Loan proceeds to the University had not been made prior to the petition date, Mr. DeMauro would not otherwise have been in possession of the Direct PLUS Loan proceeds to pay his creditors or for any other purpose. Additionally, Mr. DeMauro had no legal or equitable right to demand use of the Direct PLUS Loan proceeds in the event the USDOE denied his application. To find that the Direct PLUS Loan proceeds are property within the meaning of § 541 and therefore, property that the Trustee may recover to pay creditors would provide the Trustee with a greater interest in the Direct PLUS Loan proceeds than Mr. DeMauro had at the commencement of his Chapter 7 case.

As noted above, § 548 seeks to prevent the debtor from depleting the assets that but for the transfer would be available to creditors. Here, the inclusion of Direct PLUS Loan proceeds within § 541's definition of property would not serve § 548's purpose as the PLUS Loan proceeds would not have been available to creditors even in the absence of the transfer. Reconciliation of these two federal statutory schemes compels the conclusion that Mr. DeMauro did not have a property interest in the Direct PLUS Loan proceeds within the meaning of § 541 and the Trustee, therefore, cannot avoid the payment of the Direct PLUS Loan proceeds to the University.

VI. CONCLUSION

Because the Federal Direct PLUS Loan proceeds do not constitute an interest of the debtor in property subject to avoidance pursuant to §§ 544 and 548, the court grants summary judgment in favor of the University. As the court's ruling on this issue is dispositive, it need not reach the other issues raised in support and opposition to the motion for summary judgment and judgment for the Defendant University shall enter as to Counts One and Two of the complaint.

Dated this 19th day of June, 2018, at New Haven, Connecticut.

Ann M. Nevins
United States Bankruptcy Judge
District of Connecticut

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IN RE: Harold ADAMO, Jr. Debtor.

**Marc A. Pergament, Chapter 7 Trustee of the Estate of Harold Adamo, Jr. Plaintiff,
v.
Hofstra University, Defendant.**

**Marc A. Pergament, Chapter 7 Trustee of the Estate of Harold Adamo, Jr. Plaintiff,
v.
Fairfield University, Defendant.**

**Marc A. Pergament, Chapter 7 Trustee of the Estate of Harold Adamo, Jr., Plaintiff,
v.
Brooklyn Law School, Defendant.**

**Case No. 14–73640–LAS
Adv. Proc. No. 16–8122–CEC
Adv. Proc. No. 16–8123–CEC
Adv. Proc. No. 16–8124–CEC**

United States Bankruptcy Court, E.D. New York.

**Signed March 28, 2018
Entered March 29, 2018**

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DECISION DENYING TRUSTEE'S MOTIONS FOR SUMMARY JUDGMENT AND GRANTING DEFENDANTS' MOTIONS FOR SUMMARY JUDGMENT

CARLA E. CRAIG, Chief United States Bankruptcy Judge

In these adversary proceedings, Marc A. Pergament (the "Trustee"), the chapter 7 trustee of the estate of Harold Adamo, Jr. (the "Debtor"), seeks to recover tuition payments made by the Debtor to two undergraduate universities and a graduate school for the education of his children. Specifically, the Trustee seeks to avoid pre-petition tuition payments made by the Debtor to Hofstra University ("Hofstra") and Fairfield University ("Fairfield") as pre-petition fraudulent conveyances under 11 U.S.C. §§ 548(a)(1)(B) and 544[1] , and New York Debtor & Creditor Law ("NY DCL") §§ 273, 273–a, and 285. The Trustee also seeks to avoid post-petition tuition payments made by the Debtor to Hofstra, Fairfield, and Brooklyn Law School ("Brooklyn," and together with Hofstra and Fairfield, the "Defendants") while he was a debtor in possession under chapter 11 as unauthorized post-petition transfers pursuant to § 549.

The Trustee and the Defendants have each moved for summary judgment. The Trustee seeks summary judgment on his claims that that the pre-petition tuition payments are avoidable under NY DCL § 273–a, asserting that the Debtor did not receive reasonably equivalent value or fair consideration for the tuition payments because he was not a direct beneficiary of the tuition payments, and because he did not have a legal obligation to provide any education for his children over age 18. The Trustee also seeks summary judgment on his claim under § 549, contending that the post-petition tuition payments made by the Debtor while he was a debtor in possession were not payments made in the ordinary course, and instead were unauthorized post-petition transfers of property of the estate. The Defendants seek summary judgment on all claims, arguing, among other things, that: (1) the pre-petition transfers are not avoidable because the

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Debtor received reasonably equivalent value and fair consideration in exchange; (2) the post-petition payments were not unauthorized transfers; (3) public policy does not support the avoidance of the tuition payments; and (4) even if the transfers are avoidable, the Defendants are not initial transferees of the transfers, and are good faith subsequent transferees entitled to the protection of § 550(b).

Because the undisputed facts establish that the Debtor's children were the initial transferees of the Debtor's transfers, and that the Defendants are entitled to the good faith defense provided by § 550(b), the Trustee's motions for summary judgment are denied, and the Defendants' motions for summary judgment are granted.

JURISDICTION

This Court has jurisdiction of this core proceeding pursuant to 28 U.S.C. §§ 157(b)(2)(A) and (H), 28 U.S.C. § 1334, and the Eastern District of New York standing order of reference dated August 28, 1986, as amended by order dated December 5, 2012. The parties have expressly consented to entry of final judgment by this Court. (Tr.[2] at 99.)

BACKGROUND

The following facts are undisputed or are matters of which judicial notice may be taken, except as otherwise noted.

On August 6, 2014, the Debtor filed a voluntary petition under chapter 11 of the Bankruptcy Code. (Case No. 14–73640–LAS, ECF No. 1) On July 13, 2016, upon motion of the United States Trustee, the case was converted to one under chapter 7, and the Trustee was appointed (Case No. 14–73640–LAS, ECF Nos. 300, 301.) On August 17, 2016, the Trustee commenced these adversary proceedings. The claims register reflects that 13 claims were filed against the estate totaling $21,725,063.03. The largest claim is an unsecured claim filed by Rocco & Josephine Marini for $20,859,631.21, which is based upon a judgment entered by the United States District Court for the Eastern District of New York on April 16, 2014. (Case No. 14–73640–LAS, Claim No. 13.)

I. Hofstra University

The Debtor's son, Nicholas, attended Hofstra between 2009 and 2013, graduating with a Bachelor of Business Administration. (Trustee's E.D.N.Y. LBR 7056–1 Stmt. ¶ 13, Adv. Pro. No. 16–8122–CEC, ECF No. 25; Hofstra's E.D.N.Y. LBR 7056–1 Stmt. ¶ 9, Adv. Pro. No. 16–8122–CEC, ECF No. 23–3.) In exchange for the education provided to Nicholas, Hofstra received tuition payments. The Trustee alleges that the tuition payments totaled $121,388 (Trustee's E.D.N.Y. LBR 7056–1 Stmt. ¶ 24, Adv. Pro. No. 16–8122–CEC, ECF No. 25), but Hofstra contends that it received $118,480.00 (Hofstra's E.D.N.Y. LBR 7056–1 Stmt. ¶ 11, Adv. Pro. No. 16–8122–CEC, ECF No. 23–3; Hofstra E.D.N.Y. LBR 7056–1 Counter–Stmt. ¶ 24, Adv. Pro. No. 16–8122–CEC, ECF No. 33.).

In 2015, after the Debtor filed for bankruptcy, the Debtor's other son, Andrew, enrolled in Hofstra, and was a current student of the school as of the date of these motions. (Trustee's E.D.N.Y. LBR 7056–1 Stmt. ¶ 30, Adv. Pro. No. 16–8122–CEC, ECF No. 25; Hofstra's E.D.N.Y. LBR 7056–1 Stmt. ¶ 14, Adv. Pro. No. 16–8122–CEC, ECF No. 23–3.) In exchange for the education provided to

Andrew, Hofstra received tuition payments totaling $18,724.00. (Trustee's E.D.N.Y. LBR 7056–1 Stmt. ¶ 42, Adv. Pro. No. 16–8122–CEC,

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ECF No. 25.). Hofstra contends that the payments totaled $19,224.00 (Hofstra's E.D.N.Y. LBR 7056–1 Counter–Stmt. ¶ 42, Adv. Pro. No. 16–8122–CEC, ECF No. 33.)

Hofstra does not dispute that the funds used for these tuition payments originated from the Debtor's pre-petition and post-petition bank accounts. (Trustee's E.D.N.Y. LBR 7056–1 Stmt. ¶ 24, Adv. Pro. No. 16–8122–CEC, ECF No. 25; Pergament Aff. Exs. 8–7, 20–29, Adv. Pro. No. 16–8122–CEC, ECF Nos. 24–9 through 24–18, 24–21 through 24–30; Hofstra's E.D.N.Y. LBR 7056–1 Stmt. ¶¶ 12, 17, Adv. Pro. No. 16–8122–CEC, ECF No. 23–3.) Hofstra contends that the funds were first transferred to Nicholas or Andrew by being deposited into that student's school account. (Hofstra's E.D.N.Y. LBR 7056–1 Stmt. ¶¶ 11, 16, Adv. Pro. No. 16–8122–CEC, ECF No. 23–3.)

In connection with these motions, Hofstra submitted an affidavit of Deborah Mulligan, Hofstra's Executive Director of Student Financial Services and the University Bursar. Ms. Mulligan explains that payments in connection with a student's tuition are placed in that student's account with the school through Hofstra's electronic portal. (Mulligan Aff. ¶ 7, Adv. Pro. No. 16–8122–CEC, ECF No. 23–7.) Ms. Mulligan's affidavit further explains:

> In accordance with Hofstra University policy, the student's consent is required for a parent to even see the account balance and record of payments online. The student may register for classes at Hofstra in which case the payments in his or her student account are applied by Hofstra to the tuition balance and other University fees and charges. Conversely, the student may choose to withdraw from Hofstra classes and obtain a refund for the payments held in the student account, in accordance with the University's Refund Policy. When refunds are provided of non-loan-related payments, refunds will be provided directly to the student, regardless of whether the original payor of the funds was the student. This is because payments credited to a student's account are considered credits belonging to the student, and not to a parent or other individual who may have made a payment on the student's behalf.

(Mulligan Aff. ¶ 10, Adv. Pro. No. 16–8122–CEC, ECF No. 23–7.)

The Trustee does not dispute that the payments made by the Debtor were credited to the students' accounts (Trustee's Counter–E.D.N.Y. LBR 7056–1 Stmt. ¶ 11, Adv. Pro. No. 16–8122–CEC, ECF No. 36), or that the funds in the students' accounts were treated in accordance with the school policies.

II. <u>Fairfield University</u>

The Debtor's daughter, Francesca, attended Fairfield between August 2012 and June 2015, graduating with a Bachelor of Arts Degree. (Trustee's E.D.N.Y. LBR 7056–1 Stmt. ¶ 13, Adv. Pro. No. 16–8123–CEC, ECF No. 25; Fairfield's E.D.N.Y. LBR 7056–1 Counter–Stmt. ¶ 13, Adv. Pro. No. 16–8123–CEC, ECF No. 36; Fairfield's E.D.N.Y. LBR 7056–1 Stmt. ¶ 21, Adv. Pro. No. 16–8123–CEC, ECF No. 27–1; Trustee's E.D.N.Y. LBR 7056–1 Counter–Stmt. ¶ 21, Adv. Pro. No. 16–8123–CEC, ECF No. 33.) In exchange for the education provided to Francesca, the Trustee alleges that Fairfield received tuition payments totaling $112,870.00. (Trustee's E.D.N.Y. LBR 7056–1 Stmt. ¶ 22, Adv. Pro. No. 16–8123–CEC, ECF No. 25). Although Fairfield disputes the total amount of tuition payments received, it does not dispute that the Debtor contributed to Francesca's education by transferring funds to her account with the school. (Fairfield's E.D.N.Y. LBR 7056–1

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Counter–Stmt. ¶ 22, Adv. Pro. No. 16–8123–CEC, ECF No. 36.)

Fairfield also does not dispute that the funds used to make the tuition payments originated from the Debtor's pre-petition and post-petition accounts. However, Fairfield asserts that transfers by the Debtor were made to Francesca. Like Hofstra, Fairfield maintains an online portal in each student's name. (Fairfield's E.D.N.Y. LBR 7056–1 Stmt. ¶ 16, Adv. Pro. No. 16–8123–CEC, ECF No. 27–1; Trustee's E.D.N.Y. LBR 7056–1 Counter–Stmt. ¶ 16, Adv. Pro. No. 16–8123–CEC, ECF No. 33.) The account belongs to the student, and the student's parents have no rights in or to the account. (Fairfield's E.D.N.Y. LBR 7056–1 Stmt. ¶ 16, Adv. Pro. No. 16–8123–CEC, ECF No. 27–1; Trustee's E.D.N.Y. LBR 7056–1 Counter–Stmt. ¶ 16, Adv. Pro. No. 16–8123–CEC, ECF No. 33.) In the event the student is entitled to a refund, the student, and not a third party, receives the reimbursement. (Fairfield's E.D.N.Y. LBR 7056–1 Stmt. ¶ 18, Adv. Pro. No. 16–8123–CEC, ECF No. 27–1; Trustee's E.D.N.Y. LBR 7056–1 Counter–Stmt. ¶ 18, Adv. Pro. No. 16–8123–CEC, ECF No. 33.) The Trustee does not assert that Fairfield deviated from these policies in connection with Francesca's student account.

III. Brooklyn Law School

After graduating from Fairfield in 2015, Francesca attended Brooklyn. (Trustee's E.D.N.Y. LBR 7056–1 Stmt. ¶ 13, Adv. Pro. 16–8124–CEC, ECF No. 24.) In exchange for the education provided to Francesca, and prior to the conversion of the Debtor's case to chapter 7, Brooklyn received tuition payments totaling $27,692.42. (Trustee's E.D.N.Y. LBR 7056–1 Stmt. ¶ 15, Adv. Pro. No. 16–8124–CEC, ECF No. 24; Brooklyn's E.D.N.Y. LBR 7056–1 Counter–Stmt. ¶ 25, Adv. Pro. No. 16–8124–CEC, ECF. No. 29–2.)

Brooklyn does not dispute that the Debtor transferred funds from his post-petition accounts to be used for Francesca's law school tuition. The payments were made to Francesca's account with the school's electronic platform, BLS Connect. (Brooklyn's E.D.N.Y. LBR 7056–1 Stmt. ¶¶ 12, 13, Adv. Pro. No. 16–8124–CEC, ECF No. 22–2; Trustee's E.D.N.Y. 7056–1 Counter–Stmt. ¶¶ 12, 13, Adv. Pro. No. 16–8124–CEC, ECF No. 38.) Brooklyn "treats and considers monies deposited into the BLS Connect for students' tuition as belonging to the student." (Brooklyn's E.D.N.Y. LBR 7056–1 Stmt. ¶ 16, Adv. Pro. No. 16–8124–CEC, ECF No. 22–2; Campbell Aff. ¶ 5, Adv. Pro. No. 16–8124–CEC, ECF No. 22–2; Trustee's E.D.N.Y. 7056–1 Counter–Stmt. ¶ 16, Adv. Pro. No. 16–8124–CEC, ECF No. 38.) If the student is entitled to a refund, the refund is either made directly to the student or to the BLS Connect account. (Brooklyn's E.D.N.Y. LBR 7056–1 Stmt. ¶¶ 17, 18, Adv. Pro. No. 16–8124–CEC, ECF No. 22–2; Trustee's E.D.N.Y. 7056–1 Counter–Stmt. ¶¶ 17, 18, Adv. Pro. No. 16–8124–CEC, ECF No. 38.)

After making the payment to Francesca's BLS Connect account, the Debtor "could not access Francesca's account to view her tuition balance or records of payment without permission from Francesca." (Brooklyn's E.D.N.Y. LBR 7056–1 Stmt. ¶ 24, Adv. Pro. No. 16–8124–CEC, ECF No. 22–2; Trustee's E.D.N.Y. 7056–1 Counter–Stmt. ¶ 24, Adv. Pro. No. 16–8124–CEC, ECF No. 38.)

Brooklyn contends that, when the Debtor transferred $4,578 to Francesca's BLS Connect account on December 14, 2015, no tuition was owed. (Brooklyn's E.D.N.Y. LBR 7056–1 Stmt. ¶ 26, Adv. Pro. No. 16–8124–CEC, ECF No. 22–2.)

The Trustee does not dispute that the student accounts maintained by Hofstra, Fairfield, and Brooklyn functioned in the

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same manner: any payments received, from whatever source, were placed in the respective student's school account; funds were only applied toward tuition, and transferred to the school's general account, upon the student's registration for classes; in the even the student withdrew from the program, the student received the refund of any balance in the account. (Tr. 12–16.)

SUMMARY JUDGMENT STANDARD

Summary judgment is appropriate when "the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). In ruling upon a summary judgment motion, the court's job is not to resolve disputed issues of fact, but to determine whether a genuine issue of fact exists. See Celotex Corp. v. Catrett, 477 U.S. 317, 330, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). "When viewing the evidence, the court must 'assess the record in the light most favorable to the non-movant and ... draw all reasonable inferences in [the non-movant's] favor.' " Weinstock v. Columbia Univ., 224 F.3d 33, 41 (2d Cir. 2000) (citing Del. & Hudson Ry. Co. v. Consol. Rail Corp., 902 F.2d 174, 177 (2d Cir. 1990)), cert. denied, 540 U.S. 811, 124 S.Ct. 53, 157 L.Ed.2d 24 (2003). "The nonmoving party must show that there is more than a metaphysical doubt regarding a material fact and may not rely solely on self-serving conclusory statements." Rosenman & Colin LLP v. Jarrell (In re Jarrell), 251 B.R. 448, 450–51 (Bankr. S.D.N.Y. 2000) (citations omitted). Here, the material facts are not in dispute.

AVOIDANCE CLAIMS ASSERTED IN THE COMPLAINTS

The Trustee's claims against the Defendants to recover the pre-petition tuition payments are based on §§ 548(a)(1)(B) and 544, and NY DCL §§ 273, 273–a., and 275. The Trustee does not allege that the transfers were intentionally fraudulent under § 548(a)(1)(A).

Section 548(a)(1)(B) authorizes a trustee to avoid a transfer of an interest in property of the debtor under a theory of constructive fraud. That section provides:

> The trustee may avoid any transfer ... of an interest of the debtor in property, or any obligation ... incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
>
> (B) (i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> (ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
>
> (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

> (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or
>
> (IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

11 U.S.C § 548(a)(1)(B). The purpose of this provision is to set aside transactions that "unfairly or improperly deplete a debtor's assets" so that the assets may be made available to creditors.

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Togut v. RBC Dain Correspondent Servs. (In re S.W. Bach & Co.), 435 B.R. 866, 875 (Bankr. S.D.N.Y. 2010) (citing 5 Collier on Bankruptcy ¶ 548.01 and In re PWS Holding Corp., 303 F.3d 308, 313 (3d Cir. 2002)).

Section 544(b) authorizes a trustee to avoid a transfer of an interest in property of the debtor by utilizing applicable state law that permits such avoidance. 11 U.S.C. § 544(b). Here, the applicable law is the NY DCL.

NY DCL § 273 provides:

> Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration.
>
> N.Y. Debt. & Cred. Law § 273.

NY DCL § 273–a provides:

> Every conveyance made without fair consideration when the person making it is a defendant in an action for money damages or a judgment in such an action has been docketed against him, is fraudulent as to the plaintiff in that action without regard to the actual intent of the defendant if, after final judgment for the plaintiff, the defendant fails to satisfy the judgment.

N.Y. Debt. & Cred. Law § 273–a. This section is applicable to the Debtor because Rocco & Josephine Marini, creditors of the Debtor, commenced an action for money damages against the Debtor on September 30, 2008, obtained a judgment on April 16, 2014 for $11,304,079, plus interest, and the judgment is unsatisfied. (Pergament Aff. Ex. 5, Adv. Pro. No. 16–8122–CEC, ECF No. 24–6; Trustee's E.D.N.Y. LBR 7056–1 Stmt. ¶¶ 2, 5, 7, 8, Adv. Pro. No. 16–8122–CEC, ECF No. 25.)

NY DCL § 275 provides:

> Every conveyance made and every obligation incurred without fair consideration when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors.

N.Y. Debt. & Cred. Law § 275.

The Trustee also seeks to avoid the Debtor's post-petition tuition payments pursuant to § 549(a), which provides, in pertinent part:

> [T]he trustee may avoid a transfer of property of the estate—
>
> (1) that occurs after the commencement of the case; and
>
> (2)(A) that is authorized only under section 303(f) or 542(c) of this title; or
>
> (B) that is not authorized under this title or by the court.

11 U.S.C. § 549(a).

The Trustee's motions for summary judgment are limited to his claims under § 549 and NY DCL § 273–a, which does not require a showing of insolvency. (Tr. at 11.) The Defendants seek summary judgment on all claims.

DISCUSSION

The avoidance of pre-petition tuition payments made by a debtor for the education of his or her child is a developing body of law, and courts across the country have reached different results. Compare e.g. Geltzer v. Trey Whitfield School (In re Michel), 573 B.R. 46, 48 (Bankr. E.D.N.Y. 2017) (tuition payments for minor children were not avoidable); DeGiacomo v. Sacred Heart Univ. (In re Palladino), 556 B.R. 10 (Bankr. D. Mass. 2016) (college tuition was not avoidable); Geltzer v. Our Lady of Mt. Carmel–St. Benedicta School (In re Akanmu), 502 B.R. 124 (Bankr. E.D.N.Y. 2013) (tuition payments for minor children were

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not avoidable); Trizechahn Gateway, LLC v. Oberdick (In re Oberdick), 490 B.R. 687, 712 (Bankr. W.D. Pa. 2013) (college tuition was not avoidable under state fraudulent conveyance law); Sikirica v. Cohen (In re Cohen), Adv. No. 07-02517-JAD, 2012 WL 5360956, at *9–10 (Bankr. W.D. Pa. Oct. 31, 2012), rev'd on other grounds, 487 B.R. 615 (W.D. Pa. 2013) (college tuition was not avoidable, but graduate school tuition was avoidable under state fraudulent conveyance law) with Slobodian v. Pa. State Univ. (In re Fisher), 575 B.R. 640 (Bankr. M.D. Pa. 2017) (complaint to avoid college tuition survived motion to dismiss); Boscarino v. Bd. of Trs. of Conn. State Univ. Sys. (In re Knight), No. 15-21646 (JJT), 2017 WL 4410455, at *4 (Bankr. D. Conn. Sept. 29, 2017) (college tuition was avoidable); Roach v. Skidmore Coll. (Matter of Dunston), 566 B.R. 624, 636–37 (Bankr. S.D. Ga. 2017) (college tuition was avoidable); Eisenberg v. Penn State Univ. (In re Lewis), Adv. No. 16-0282, 574 B.R. 536, 2017 WL 1344622 (Bankr. E.D. Pa. Apr. 7, 2017) ; Gold v. Marquette Univ. (In re Leonard), 454 B.R. 444 (Bank. E.D. Mich. 2011) (college tuition was avoidable); Banner v. Lindsay (In re Lindsay), Adv. No. 08-9091 (CGM), 2010 WL 1780065, at *9 (Bankr. S.D.N.Y. May 4, 2010) (college tuition was avoidable). The courts that have addressed this issue have considered a number of factors, including whether the child is a minor, Michel, 573 B.R. 46 ; Akanmu, 502 B.R. 124 ; whether the tuition was for necessary education or extracurricular activities, Oberdick, 490 B.R. 687 ; whether the education was primary, undergraduate, or graduate education, Akanmu, 502 B.R. 124 ; Cohen, 2012 WL 5360956 ; and whether the debtor, by making the payments, satisfied a legal or moral obligation or other societal expectation, Knight, 2017 WL 4410455, Michel, 573 B.R. 46 ; Akanmu, 502 B.R. 124 ; Oberdick, 490 B.R. 687 ; Cohen, 2012 WL 5360956.

Although the question whether a debtor receives fair consideration or reasonably equivalent value in exchange for undergraduate and graduate tuition payments for adult children is interesting, it need not be decided in the context of these motions. Rather, the result here is dictated by § 550, which governs a transferee's liability on an avoided transfer.

Section 550, provides in pertinent part:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of [the Bankruptcy Code], the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.
>
> (b) The trustee may not recover under section (a)(2) of this section from—
>
> (1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or
>
> (2) any immediate or mediate good faith transferee of such transferee.

11 U.S.C. § 550.

The Defendants argue that, based upon the structure of the student portals, they are not the initial transferees of the transfers. They argue that the Debtor's children were the initial transferees because, once funds are transferred to a student's account from any outside source, only that student has access to and control over the funds. The Trustee contends that the Defendants are the initial transferees because the payments were made for the purpose

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of paying the tuition, and the Defendants ultimately received the funds.

"The trustee of a bankrupt estate has broad powers under the Bankruptcy Code to avoid certain transfers of property made by the debtor either after or shortly before the filing of the bankruptcy petition." Christy v. Alexander & Alexander of N.Y. Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey), 130 F.3d 52, 55 (2d Cir. 1997). However, "[a]voidance and recovery of ... transfers 'are distinct concepts and processes.' " Nisselson v. Salim (In re Big Apple Volkswagen, LLC), No. 11-11388 (JLG), 2016 WL 1069303, at *14 (Bankr. S.D.N.Y. Mar. 17, 2016) (quoting Suhar v. Burns (In re Burns), 322 F.3d 421, 427 (6th Cir. 2003)). Even if a transfer is subject to avoidance, recovery may depend on whether the defendant is the initial transferee. "If the recipient of debtor funds was the initial transferee, the bankruptcy code imposes strict liability and the bankruptcy trustee may recover the funds." Red Dot Scenic Inc. v. Tese–Milner (In re Red Dot Scenic, Inc.), 351 F.3d 57, 58 (2d Cir. 2003) (per curiam). On the other hand, if the defendant is not the initial transferee, it may be entitled to assert a good faith defense under § 550(b). Id.

It is well established that "the minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put the money to one's own purposes." Finley, Kumble, 130 F.3d at 57 (quoting Bonded Fin. Servs. v. European Am. Bank, 838 F.2d 890, 893 (7th Cir. 1988)). This requirement is satisfied when a party "may dispose of [the transferred asset] as he or she pleases such as 'invest [ing] the [whole] amount in lottery tickets or uranium stock.' " Secs. Inv'r Prot. Corp. v. Stratton Oakmont, Inc., 234 B.R. 293, 313 (Bankr. S.D.N.Y. 1999) (quoting Finley, Kumble, 130 F.3d at 57 (citing Bonded, 838 F.2d at 894)).

In these adversary proceedings, the undisputed facts establish that the Defendants did not exercise dominion and control over the tuition payments at the time of the Debtor made the transfers. Rather, the payments were made to the students' accounts, which were created by the student with a unique username and password.[3] After the Debtor transferred the funds to those accounts, the Debtor was not able to access the account absent the account holder's authorization, nor were the Defendants authorized to utilize the funds. Rather, the Defendants did not obtain dominion and control of those funds until the student registered for classes for that semester, at which point the funds would be applied towards the tuition amount due. (Tr. at 13, 16.) In the event the student decided to withdraw from the program, the student, and not the Debtor or the Defendants, was entitled to any funds remaining in the account. (Tr. at 13, 16.) Put simply, the student maintained dominion and control over the funds in the account upon the Debtor's transfer because it was the student's decision whether to enroll in classes and have the funds applied towards tuition or to withdraw from the program and have the funds refunded directly to him or her.

The Trustee argues that the Defendants' argument is undermined by the Debtor's intention to pay the tuition. In support of this argument, the Trustee points to an affidavit by the Debtor in which he swears that he "made tuition payments to

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Brooklyn." (Trustee's Mem. of Law in Opp'n to Brooklyn Law School's Motion for Summ. J. at 8, Adv. Pro. No. 16–8124–CEC, ECF No. 32.) However, the Debtor's intention does not change the legal conclusion that the initial transfer was actually to his children, who subsequently transferred the funds to the Defendants for their tuition. Also unpersuasive is the Trustee's argument that, had the children withdrawn from the programs, they would have given the refund to the Debtor. The children had no legal obligation to return the funds to their father. They could have chosen to take a trip or go on a shopping spree, and deal with their father's anger.

These student portals are akin to bank accounts, with the Defendants as the financial institutions maintaining those accounts. It is well established that, when funds are transferred to an account holder's bank account, the account holder, and not the financial institution, is the initial transferee. In this situation, the bank is a conduit. See Finley, Kumble, 130 F.3d at 59 ("[A] commercial entity that, in the ordinary course of its business, acts as a mere conduit for funds and performs that role consistent with its contractual undertaking in respect of the challenged transaction, is not an initial transferee within the meaning of § 550(a)(1)."); Bonded Fin. Servs., 838 F.2d at 893 ("When A gives a check to B as agent for C, then C is the 'initial transferee'; the agent may be disregarded."). "[T]he mere conduit doctrine 'envisions that there are three relevant parties: the transferor, the conduit, and a third party who receives the transferred funds from the conduit.' " McCord v. Ally Fin., Inc. (In re USA United Fleet, Inc.), 559 B.R. 41, 64 (Bankr. E.D.N.Y. 2016) (quoting Bear, Stearns Secs. Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.), 397 B.R. 1, 15 (S.D.N.Y. 2007)). This doctrine is typically invoked by a financial institution or broker as a defense to a fraudulent conveyance claim, asserting that it is not liable because it is a "mere conduit," and not an initial transferee of the property, id. (citing Bear, Stearns, 397 B.R. at 15), but fits easily into the framework of the student portal structure utilized by the defendants in these cases.

The Defendants maintained the electronic platform in which the student accounts were created, and were mere conduits in the initial transfer from the Debtor to his children. The fact that the funds were subsequently transferred from the children to the Defendants to pay their tuition obligations does not change the conclusion that the original transfer was from the Debtor to his children. See Bonded Fin. Servs., 838 F.2d at 895–896. Therefore, as subsequent transferees, the Defendants may assert the good faith defense provided by § 550(b). The Trustee does not dispute that the Defendants provided value to the children, in the form of enrollment in classes and education, in good faith in exchange for the tuition payments. To the extent the Trustee argues that, in order to invoke the good faith defenses under § 550(b), value must have been provided to the Debtor (Tr. at 80:25), he is incorrect. Bonded Fin. Servs., 838 F.2d at 897 ("The statute does not say "value to the debtor"; it says "value".... All of the courts that have considered this question have held or implied that value to the transferor is sufficient.").

The Second Circuit's decision in In re Red Dot Scenic, Inc., 351 F.3d 57, does not lead to a different conclusion. In that case, the sole shareholder of Red Dot Scenic, Inc. issued four checks drawn on the company's checking account payable to the defendant in payment of a personal debt arising from the sole shareholder's purchase of the defendant's interest in the company. Red Dot Scenic, 351 F.3d at 58. After the company filed for bankruptcy,

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the trustee commenced an action against the defendant seeking to recover those transfers as fraudulent conveyances. Id. The defendant argued that the sole shareholder, for whose benefit the payments were made, was the initial transferee, and that the defendant was a subsequent transferee entitled to invoke the good faith defense. Id. The Second Circuit rejected that argument because "the funds moved directly from Red Dot's account directly to [him]." Id. At the time the funds were transferred to the defendant, he "could invest the whole amount as he chose." Tese–Milner v. Brune (In re Red Dot Scenic, Inc.), 293 B.R. 116, 119 (S.D.N.Y. 2003), aff'd 351 F.3d 57 (2003). In these adversary proceedings, however, the funds were not transferred directly from the Debtor to the Defendants, such that the Defendants could use "the whole amount as [they] chose." Id. Rather, the funds were transferred to the student accounts, and were transferred to Defendants from the student accounts only when, and in the event that the student decided to register for classes for that semester. Had the student decided against enrolling, the Defendants were not authorized to utilize the funds in the account.

The facts presented in these adversary proceeding are similar to those in Bonded Financial Services, Inc. v. European American Bank, 838 F.2d 890 (7th Cir. 1988). In that case, Bonded Financial Services ("Bonded") sent European American Bank (the "Bank") a check for $200,000, with a note directing the Bank to deposit this check into the account of Michael Ryan, who controlled Bonded. Bonded Fin. Servs., 838 F.2d at 891. Subsequently, Ryan instructed the Bank to debit the account by $200,000 and apply those funds to pay a loan made by the Bank to one of Ryan's other businesses. Id. Shortly thereafter, Bonded filed for bankruptcy, and the trustee sought to recover from the Bank the pre-petition payment made by Bonded as a fraudulent conveyance under § 548(a). Id. The Bankruptcy Court for the Northern District of Illinois granted summary judgment for the Bank, and the district court affirmed. Id. Analyzing § 550, the district court determined that, at the time the initial $200,000 payment was made, the Bank was not an initial transferee, but was a mere conduit, and that Ryan was the initial transferee. Id. In affirming the district court's decision, the Seventh Circuit explained:

> If the note accompanying Bonded's check had said: "use this check to reduce Ryan's loan" instead of "deposit this check into [Ryan]'s account", § 550(a)(1) would provide a ready answer. The Bank would be the "initial transferee" and Ryan would be the "entity for whose benefit [the] transfer was made". The trustee could recover the $200,000 from the Bank, Ryan, or both, subject to the rule of § 550(c) that there may be but one recovery. The trustee contends that the apparently formal difference-depositing the check in Ryan's account and then debiting that account-should not affect the outcome. In either case the Bank is the payee of the check and ends up with the money .... From a larger perspective, however, the two cases are different.
>
> * * *
>
> As the Bank saw the transaction on [the date it received the check], it was Ryan's agent for the purpose of collecting a check from Bonded's bank. It received nothing from Bonded that it could call its own; the Bank was not Bonded's creditor, and Ryan owed the Bank as much as ever. The Bank had no dominion over the $200,000 until ... Ryan instructed the Bank to debit the account to reduce the loan; in the interim, so far as the Bank was concerned, Ryan was

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> free to invest the whole $200,000 in lottery tickets or uranium stocks. As the Bank saw things on [the date it applied the funds to reduce the loan], it was getting Ryan's money.... So the two-step transaction is indeed different from the one-step transaction we hypothesized at the beginning of this discussion.

Bonded Fin. Servs., 838 at 892–94 (citation omitted). The Seventh Circuit also rejected the trustee's argument that the Bank was the "entity for whose benefit" the transfer was initially made because, even though the Bank was the ultimate recipient, "a subsequent transferee cannot be the 'entity for whose benefit' the initial transfer was made." Id. at 895. On the other hand, "[i]f Bonded had sent a check to the Bank with instructions to reduce Ryan's loan, the Bank would have been the initial transferee and Ryan the 'entity for whose benefit'." Id.

Bonded is exactly on point. Although the funds transferred by the Debtor to the students' accounts were ultimately received by the Defendants as tuition payments, at the time of the initial transfer by the Debtor, the Defendants' electronic system was merely holding the funds on behalf of the student account holders. The Defendants were mere conduits, and did not have dominion and control over the funds; rather, the students did. To the extent the Trustee argues the opposite, that the students' accounts were mere conduits to the Defendants, he is incorrect. A conduit is an entity that holds the transferred asset for the true recipient, and has no legal right to utilize the asset while in its possession. Finley, Kumble, 130 F.3d at 56–58 (adopting Bonded Fin. Servs.); Bonded Fin. Servs., 838 F.2d at 893 ("[T]he minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put the money to one's own purposes."). Here, the children had the power to withdraw from the programs and receive the funds to use as they wish. The

Defendants only received dominion and control over the funds once the students enrolled in classes and the funds were applied to the tuition bill.

CONCLUSION

For the foregoing reasons, the Trustee's motions for summary judgment are denied, and the Defendants' motions for summary judgment are granted. Separate orders will issue.

Notes:

[1] Unless otherwise indicated, all statutory references herein are to the Bankruptcy Code, Title 11, U.S.C.

[2] "Tr." refers to the transcript of the hearing on these motions held on November 14, 2017.

[3] The funds were placed into the student's account whether the payment was made by personal check or electronic transfer. (Tr. at 14.)

Marc A. Pergament, as Chapter 7 Trustee of the Estate of Harold Adamo Jr., Appellant, v. Brooklyn Law School, Appellee.

Marc A. Pergament, as Chapter 7 Trustee of the Estate of Harold Adamo Jr., Appellant, v. Fairfield University, Appellee.

Marc A. Pergament, as Chapter 7 Trustee of the Estate of Harold Adamo Jr., Appellant, v. Hofstra University, Appellee.

1:18-CV-2204 (ARR)
1:18-CV-2235 (ARR)
1:18-CV-2236 (ARR)

UNITED STATES DISTRICT COURT EASTERN DISTRICT OF NEW YORK

January 4, 2019

Amended Opinion & Order

ROSS, United States District Judge:

In this consolidated bankruptcy appeal, the appellant, a bankruptcy trustee, seeks to overturn the determination of the bankruptcy court that he cannot recover from three institutions of higher learning payments that the debtor made for his children's education.

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Specifically, the bankruptcy court ruled that the schools were not "the initial transferee[s]" of the payments within the meaning of 11 U.S.C. § 550(a) but rather subsequent transferees that took in good faith from the debtor's children, and thus that the schools were entitled to the protections of § 550(b).

The bankruptcy court's analysis of this thorny issue was sound, but because the bankruptcy court appears not to have grappled with a key factual question, I vacate the decision below and remand the cases for further proceedings.[1]

BACKGROUND

On September 30, 2008, a lawsuit was filed against the debtor in these bankruptcy actions, alleging that the debtor had "bilk[ed]" his friend out of "millions of dollars" by encouraging the friend to buy coins from the debtor at inflated prices. *See* Complaint at 1, *Marini v. Adamo*, 995 F. Supp. 2d 155 (E.D.N.Y. 2014) (No. 08-CV-3995).

While that litigation proceeded, the debtor's son Nicholas in 2009 matriculated at appellee Hofstra University, which he attended until his graduation in 2013. Appellant App. Pt. I, at TA0006, ECF No. 5-1.[2] And from April 2009 until December 2012, the debtor made payments totaling approximately $120,000 to Hofstra for Nicholas's tuition. *See id.*; Appellant App. Pt. II, at TA0212-30, ECF No. 5-2.

Similarly, in 2012, the debtor's daughter Francesca matriculated at appellee Fairfield University, which she attended until her graduation in 2015. Appellant App. Pt. I, at TA0008. From August 2012 until December 2013, the debtor made payments totaling approximately

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$90,000 to Fairfield for Francesca's tuition. *See id.*; Appellant App. Pt. IV, at TA0632-40, TA0661, ECF No. 5-4.[3]

Meanwhile, the lawsuit against the debtor came to a close. On February 6, 2014, after a bench trial, Judge Joseph F. Bianco of this district ruled for the plaintiffs in that action (*Marini*, 995 F. Supp. 2d 155, *aff'd*, 644 F. App'x 33 (2d Cir. 2016)), and on April 16, 2014, the court entered judgment against the debtor in the amount of $11,304,079, plus interest (Judgment at 1, *Marini*, 995 F. Supp. 2d 155 (No. 08-CV-3995)). That was evidently more than the debtor could afford, and he filed a chapter 11 bankruptcy petition on August 6, 2014 (Appellant App. Pt. I, at TA0005).

While his bankruptcy case proceeded, however, the debtor continued to spend money on his children's higher education. In 2015, the debtor's son Andrew matriculated at Hofstra, and Francesca began attending appellee Brooklyn Law School. *Id.* at TA0006, TA0009. Between May 2015 and July 2016, the debtor made payments totaling approximately $20,000 to Hofstra for Andrew's tuition and payments totaling $27,692.42 to Brooklyn Law for Francesca's tuition. *See id.*; Appellant App. Pt. II, at TA0250-68; Appellant App. Pt. III, at TA0516-22, ECF No. 5-3.

Then on July 13, 2016, the bankruptcy court converted the debtor's chapter 11 case to a chapter 7 case and ordered the appointment of a trustee. *See* Appellant App. Pt. I, at TA0005. On August 17, 2016, that trustee, the appellant here, initiated adversary proceedings in the

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bankruptcy court against the three schools to avoid and recover from them all the above-mentioned tuition payments. *See id.* at TA0004-05.[4]

On March 28, 2018, on cross-motions for summary judgment in the three adversary proceedings, the bankruptcy court granted summary judgment to the schools in a single opinion, ruling that "the undisputed facts establish that the Debtor's children were the initial transferees of the Debtor's transfers, and that the [schools] are entitled to the good faith defense provided by § 550(b)." *Id.* at TA0005. Critical to its decision, the bankruptcy court found it undisputed that all three schools treated tuition payments that they received in substantially the same way:

> [A]ny payments received, from whatever source, were placed in the respective student's school account; funds were only applied toward tuition, and transferred to the school's general account, upon the student's registration for classes; in the event the student withdrew from the program, the student received the refund of any balance in the account.

Id. at TA0010.

That grant of summary judgment is the subject of this appeal. Because the trustee has conceded that the schools took the payments in good faith, the sole question on appeal is whether the schools are initial transferees or subsequent transferees under § 550 of the Bankruptcy Code.[5]

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STANDARD OF REVIEW

"[I]n bankruptcy appeals, the district court reviews the bankruptcy court's factual findings for clear error and its conclusions of law de novo." *R² Invs., LDC v. Charter Commc'ns, Inc. (In re Charter Commc'ns, Inc.)*, 691 F.3d 476, 482-83 (2d Cir. 2012) (citation omitted). Because the bankruptcy court ruled for the schools on cross-motions for summary judgment, I view the facts "in the light most favorable" to the trustee (*Christy v. Alexander & Alexander of N.Y. Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey)*, 130 F.3d 52, 55 (2d Cir. 1997)). *See Bear, Stearns Sec. Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.)*, 397 B.R. 1, 7 n.10 (S.D.N.Y. 2007).[6]

DISCUSSION

Section 550 provides that, when a transfer is avoided under certain sections of the Bankruptcy Code, "the trustee may recover, for the benefit of the estate, the property transferred," from either "the initial transferee of such transfer" or "any [subsequent] transferee of such initial transferee." § 550(a).[7] The trustee may *not* recover from a subsequent "transferee that takes for value . . . , in good faith, and without knowledge of the voidability of the transfer avoided." § 550(b)(1). No such good-faith exception applies for initial transferees. *See Carroll v. Tese-Milner (In re Red Dot Scenic, Inc.)*, 351 F.3d 57, 58 (2d Cir. 2003). Thus, where, as here, the transferees' good faith is not in dispute, much depends on the determination of whether transferees were initial transferees or subsequent transferees.

The Bankruptcy Code does not define "initial transferee," but a body of case law has developed that distinguishes "the initial recipient—that is, the first entity to touch the disputed

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funds—[from] the initial transferee." *Finley*, 130 F.3d at 56. The seminal case in this line is *Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890 (7th Cir. 1988), in which the Seventh Circuit ruled that "the minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put the money to one's own purposes." *Id.* at 893. In *Finley*, the Second Circuit endorsed *Bonded* and adopted what it called "the 'mere conduit' test for determining who is an initial transferee under § 550(a)(1)." 130 F.3d at 57-58. Since *Finley*, the law in this circuit is that "an initial transferee must exercise dominion over the funds at issue and be able to put them to 'his own purposes'" and that "a party is *not* an initial transferee if it was a 'mere conduit' of the funds." *Manhattan Inv. Fund*, 397 B.R. at 15. "A 'mere conduit' . . . has no dominion or control over the asset; rather, it is a party with actual or constructive possession of the asset before transmitting it to someone else. Mere conduits can do no more than transmit a transferor-debtor's funds to a transferee." *Authentic Fitness Corp. v. Dobbs Temp. Help Servs., Inc. (In re Warnaco Grp., Inc.)*, No. 03 Civ. 4201(DAB), 2006 WL 278152, at *6 (S.D.N.Y. Feb. 2, 2006).

A. Whether the schools were mere conduits or initial transferees of the tuition payments depends on when the payments were made.

Tuition for an undergraduate or law degree is not owed all at once. Rather, it is typically collected on a periodic basis, such as per semester. *See, e.g.*, Appellant App. Pt. IV, at TA0751 (stating that, at Fairfield, "[t]uition invoices are sent out in July for the following Fall Semester and in December for the following Spring Semester"). And, at least in the case of the appellee schools, students who withdraw from their program may be entitled to a refund of tuition payments already made on their behalf, depending on how early in the school year they withdraw. *See* Appellant App. Pt. I, at TA0010. Whether the schools exercise dominion and control over tuition payments immediately upon receipt thus depends on when each particular payment is made. As explained below, in the case of any tuition paid early enough that the

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recipient school would have been obligated to refund it to the student if he or she then withdrew, the school must be classified as a mere conduit and the student an initial transferee, regardless of whether the student actually withdrew from school. But as for tuition paid so late that the student could never have had any right to obtain it, even had he or she withdrawn from school immediately, the school had dominion and control from the outset and thus is properly considered the initial transferee. For clarity, I refer to payments of the first type as "refundable" and payments of the second type as "nonrefundable."

1. As to refundable payments, the bankruptcy court found that the Seventh Circuit's landmark decision in *Bonded* was "exactly on point" (*id.* at TA0021). Although the fact patterns can be differentiated, I agree with the bankruptcy court that *Bonded* shows why the schools cannot be considered initial transferees of these payments.

In *Bonded*, a debtor "sent [a] Bank a check payable to the Bank's order . . . with a note directing the Bank to 'deposit this check into [a third party]'s account.'" *Bonded*, 838 F.2d at 891. Once the money was routed into the account, the third party "instructed the Bank to debit the account $200,000" as repayment of a loan that he owned the bank. *Id.* The trustee in that case argued that the bank was the initial transferee of the debtor "because [the bank] was the payee of the check it received," but the court rejected this argument, ruling that the bank "acted as a financial intermediary" and "received no benefit" from the initial transfer. *Id.* at 891, 893. The Seventh Circuit's reasoning is instructive, as the facts are reminiscent of this appeal:

> [The bank] received nothing from [the debtor] that it could call its own . . . . The Bank had no dominion over the $200,000 until . . . [the third party] instructed the Bank to debit the account to reduce the loan; in the interim, so far as the Bank was concerned, [the third party] was free to invest the whole $200,000 in lottery tickets or uranium stocks.

Id. at 893-94.

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Just so here: even though the schools received the tuition payments directly from the debtor and eventually applied those payments toward his children's incurred tuition charges, the schools did not have dominion over the tuition payments until the children no longer had any legal right to a refund. Before then, the schools' retention of the payments was subject to the possibility that the debtor's children would withdraw from school and take the money with them, and thus the schools had insufficient dominion and control at that point to be considered initial transferees. *See Meoli v. Huntington Nat'l Bank*, 848 F.3d 716, 725 (6th Cir. 2017) ("As our sister circuits have explained, the account-holder's right to withdraw the deposits keeps the bank from obtaining dominion and control."); *cf. Menotte v. United States (In re Custom Contractors, LLC)*, 745 F.3d 1342, 1350 n.6 (11th Cir. 2014) ("[A] party who has nearly unlimited ability to use funds does not, for the purposes of our mere conduit or control test, 'control' those funds when there exists an obligation to provide those funds to a third party.").

2. By the same logic, the schools were the initial transferees of any nonrefundable tuition payments. "[W]hen an initial recipient receives funds as payment of an existing debt, the recipient exercises sufficient control to be held liable as an initial transferee." *Custom Contractors*, 745 F.3d at 1350. That's because in that situation, "neither the transferor, nor any other party, has any rights . . . in the funds held by the initial transferee." *Id.*

In *Bonded*, for example, the court posited that if the check in that case had come with the instructions, "'use this check to reduce [the account holder's] loan' instead of 'deposit this check into [his] account,'" then the bank would indeed have been the initial transferee, for the third-party account holder would never have had dominion over the money. 838 F.2d at 892; *see also Red Dot*, 351 F.3d at 58 (ruling that party "who exercised no control over the funds at issue once they were transferred from [the debtor]'s account[ ] was not the initial transferee"). Similarly here, for any payments that the debtor made after the schools no longer had any

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obligation to issue a refund, the schools were the initial transferees, since at no time did the children have any dominion over the money.

B. The parties' arguments to the contrary fail.

1. The debtor's children were not mere conduits.

The trustee does not forcefully dispute that the schools were mere conduits of refundable tuition payments but argues that the "Debtor's children were mere conduits of the Tuition Payments" as well (Appellant Br. 15, ECF No. 5). The trustee argues that it was "the common understanding of all parties that the purpose of the Tuition Payments was to fund the Debtor's children's educations and that the sole function of the Debtor's children in the transaction was to attend school." Reply Br. 6, ECF No. 12.

The trustee is right that that fact distinguishes these cases from *Bonded*, in which the account holder might plausibly have used the money in his account for any number of things. *See Bonded*, 838 F.2d at 894; Appellant Br. 20. Ultimately, however, this distinction does not lead to a different conclusion: For one thing, if the debtor's children had withdrawn from school, they could have used the refunded money "however [they] wanted to" (*Meoli*, 848 F.3d at 728). *See* Appellant App. Pt. I, at TA0017 ("The children had no legal obligation to return the funds to their father. They could have chosen to take a trip or go on a shopping spree . . . ."). Moreover, the existence of *some* restrictions on how a recipient of funds uses its money does not prevent that party's being considered an initial transferee. *See Manhattan Inv. Fund*, 397 B.R. at 18 ("[A] party can be an initial transferee even if it cannot use received funds for endeavors unrelated to the underlying transaction.").

The trustee insists that "the Debtor's children were obligated to use the Tuition Payments to secure college/law school diplomas" (Reply Br. 6), but he offers no legal support for this conclusory assertion. Yet even if the debtor's children had somehow obligated

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themselves to spend the money transferred to their school accounts on their education, it is not clear that that would change the result. *Lowry v. Security Pacific Business Credit, Inc. (In re Columbia Data Products, Inc.)*, 892 F.2d 26 (4th Cir. 1989), demonstrates that an initial transferee is not rendered a mere conduit simply because it has already pledged to use the transferred funds in a certain way. In *Lowry*, the Fourth Circuit ruled that a corporation that had received funds from a debtor was the initial transferee of those funds, notwithstanding that the corporation had previously assigned its accounts receivable to another corporation and thus that other corporation ultimately received the funds. *See id.* at 27-29. Applying *Bonded*, the court observed that the recipient "used the funds for its own purpose"—that is, "to reduce its debt" to the assignee corporation. *Id.* at 29. "The fact that [the initial transferee] could not have used the funds for other purposes" was irrelevant. *Id.* If the debtor's children in these cases were similarly obligated to give the money in their school accounts to the respective schools, they would still be using the money for their own purposes—obtaining degrees.

The trustee tries to distinguish *Lowry* by citation to *CNB International, Inc. Litigation Trust v. Lloyds TSB Bank PLC (In re CNB International, Inc.)*, 440 B.R. 31 (W.D.N.Y.

2010), in which the court seemed to suggest that the intentions of the debtor are legally relevant to the initial-transferee analysis. *See* Appellant Br. 24. A careful reading of *CNB*, however, reveals that that case turns not on the debtor's intentions but on the fact that the transfer occurred only because the initial recipient was contractually bound to transfer the funds to the ultimate transferee.

In *CNB*, the debtor planned to purchase a corporation whose assets had previously been pledged to a bank. *See* 440 B.R. at 35. The transfer at issue was part of a multiparty transaction in which, "[p]ursuant to written instructions approved ahead of time by all parties," the debtor first transferred money to the corporation and then that money was "immediately disbursed" from the corporation to the bank. *Id.* at 36. "In exchange, [the bank] released its

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. . . security interest in the assets of [the corporation] being purchased by [the debtor]." *Id.* On those facts, the court ruled that the corporation "constituted a mere conduit and [the bank] was the initial transferee." *Id.* at 41.

The trustee notes that the court in *CNB* explicitly distinguished *Lowry*:

> [T]he *transferor* in *Lowry* did not care what the initial transferee did with the funds once they left the *transferor's* possession; at that point the funds were at the discretion of the initial transferee, which discretion the transferee had already exercised by contracting with the subsequent transferee. In contrast, CNB, as the transferor, would not have transferred its funds in the first instance if [the initial recipient] had not been bound to transfer them immediately to [the bank] in exchange for, *inter alia*, the release of [the bank's] . . . security interest.

Id. at 40-41 (citations omitted). Based on this language, the trustee argues that the schools should be considered initial transferees because the debtor here similarly "cared immensely about what was done with the Tuition Payments once they left his bank account." Appellant Br. 24.

The trustee's argument is reasonable but, in the end, unconvincing. As the *CNB* court stated, "the *crucial distinction* between the *Lowry* transaction and the [*CNB*] Transaction is that the initial transfer from CNB was contractually conditioned upon, *inter alia*, [the recipient's] immediate transfer of funds to [the bank]." 440 B.R. at 40 (emphasis added). The recipient in *CNB* thus "never had any discretion to do anything else with the [money]." *Id.*; *see also Finley*, 130 F.3d at 59 (holding that defendant's "role in the transfers of funds was that of a mere conduit" where defendant "had no discretion or authority to do anything else but transmit the money"). The trustee here acknowledges that the debtor's children were not contractually required to do anything (*see* Reply Br. 6); rather, as long as they remained entitled to a refund

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of tuition, they had the discretion to do anything they wanted with the transferred money.[8] That suffices to distinguish this appeal from *CNB*.

The trustee also argues that the "Debtor's children [lacked] dominion and control over the Tuition Payments" because they did not believe that, "in the hypothetical event" that they dropped out of school, they had the option to "spend[ ] their father's money on a trip or shopping spree, as opposed to returning the money to Debtor." Appellant Br.

21. And the trustee asserts that, "as between the Debtor and his children, the obligation of the Debtor's children to pursue college degrees was no less real or definite than [a] contractual obligation." Reply Br. 11.

The debtor's children's beliefs and decisions are irrelevant. It may be true that they would have returned any refunded tuition to their father, but what matters is that they had the legal right to keep it. *See, e.g., 718 Arch St. Assocs., Ltd. v. Blatstein (In re Blatstein)*, 260 B.R. 698, 717-18 (E.D. Pa. 2001) (distinguishing "question of whether one may or may not have *exercised* control over fraudulently transferred funds" from "question of whether one had the *right* to exercise control over fraudulently transferred funds"; and observing that "the 'dominion and control' test is purely concerned with rights"); *Helms v. Roti (In re Roti)*, 271 B.R. 281, 296 (Bankr. N.D. Ill. 2002) (finding that debtor's daughters were transferees because they "possessed the right to put the [transferred] money to their own use" even though they "acted in accord with the Debtor's directions, and did not utilize the proceeds for their own benefit"), *aff'd sub nom. Nelmark v. Helms*, No. 02 C 0925, 2003 WL 1089363 (N.D. Ill. Mar. 11, 2003).

It doesn't matter whether the children knew that they had the right to keep the money (*see, e.g., Whitlock v. Lowe*, 569 B.R. 94, 100 (W.D. Tex. 2017) ("Whether she knew that the status of the account had changed from a joint account . . . to an account solely under her

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name, [the initial transferee] had the legal right to put the funds to any use she wished."), *appeal docketed*, No. 18-50335 (5th Cir. Apr. 26, 2018); *Roti*, 271 B.R. at 296 ("[The debtor's daughters'] subjective beliefs do not override the undisputed fact that they had the authority to withdraw the funds for their own purposes.")), and any familial or moral pressure that they may have felt is similarly beside the point (*see, e.g., Taunt v. Hurtado (In re Hurtado)*, 342 F.3d 528, 535 (6th Cir. 2003) (ruling that mother of debtors was initial transferee where she "had legal authority to do what she liked with the [transferred] funds" and there was "no evidence of some formal contractual arrangement that required her to obey the debtors' commands"); *Whitlock*, 569 B.R. at 101 ("She may have felt pressure to follow the instructions of her family members, but there is no evidence that she was legally obligated to do so.")).[9]

Finally, the trustee urges me to follow the decision of the bankruptcy court for the Middle District of Florida in *Tardif v. St. John the Evangelist Catholic Church (In re Engler)*, 497 B.R. 125 (Bankr. M.D. Fla. 2013), in which an entity that received payments earmarked for a third party was found to be a mere conduit. *See* Appellant Br. 16-17. In *Engler*, the debtors transferred money to their church for the benefit of a newly created nonprofit organization. 497 B.R. at 127-28.[10] The money was deposited into the church's "general operating account" and "commingled with the Church's general operating revenue," but the church maintained "a bookkeeping subaccount to separately account for . . . donations [for the nonprofit]" and disbursed the funds to the nonprofit upon the nonprofit's request. *Id.* at 128. The *Engler* court

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ruled that the church was a "mere conduit" because, "[d]espite depositing the [nonprofit's] donations into its general operating account, the Church was not free to use that money as it wished." *Id.* at 130. Because "the Debtors[ ] specifically earmarked their donations for the [nonprofit]," the court reasoned, "[t]he Church's use of the Debtors' donation was circumscribed by its legal obligations to the Debtors and the [nonprofit]." *Id.*

The trustee argues that the debtor's children are akin to the church in *Engler* and that the schools are like the nonprofit. *See* Appellant Br. 17 ("By issuing checks payable to [the schools], Debtor 'earmarked' the Tuition Payments for [the schools], precluding Debtor's children from using the Tuition Payments for purposes other than attending school and rendering them mere conduits of those payments.").

I do not agree. It is the schools that are like the *Engler* church, and the debtor's children resemble the nonprofit. *Cf.* Fairfield Br. 21, ECF No. 10 ("[T]he plain old common sense reality [is] that the Payments were made by Debtor to benefit Francesca, not Fairfield.") In *Engler*, the court's finding that the debtors had "earmarked their contribution for the [nonprofit]" was based on "the memo line of the check"—of which the church was the payee—"specifically" designating the money for the nonprofit. 497 B.R. at 128. Just the same, the debtor here made payments to the schools but instructed them that the payments were for the benefit of his children. *See, e.g.*, Appellant App. Pt. II, at TA0212-30 (showing checks from debtor, made out to Hofstra, designating "Nicholas Adamo" in memo line); *see also* Hofstra Br. 28, ECF No. 9 ("[T]he checks the Debtor made payable to Hofstra including Nicholas'[s] name and account number on the memo line . . . show that Hofstra was a mere conduit to Nicholas . . . just as the church was a mere conduit of the checks received in *Engler*."); *cf.* Fairfield Br. 20-21 ("[I]n *Engler* . . . the church had the . . . legal obligation to return the funds

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it was holding as 'earmarked' while here . . . Francesca had no legal obligation to return the Payment to her father."). The schools were mere conduits; the debtor's children were not.

2. The result here is not dictated by the schools' internal bookkeeping.

As a matter of policy, the trustee argues that it would be "unjust" for the result in these cases to turn on the existence of a "student account system" that the schools "created for their own use and benefit." Reply Br. 10. "Had Appellees not established accounts in their respective students' names," the trustee asserts, "there would be no question as to Appellees' status as initial transferees under Section 550." *Id.* at 3.

The trustee is correct that the schools' internal bookkeeping practices ought not affect the parties' substantive legal rights. Although the bankruptcy court emphasized the existence of the student accounts (*see, e.g.*, Appellant App. Pt. I, at TA0017 ("These student portals are akin to bank accounts, with the [schools] as the financial institutions maintaining those accounts.")), the outcome in these cases does not hinge on the existence of the accounts (*cf. id.* ("Put simply, the student maintained dominion and control over the funds in the account . . . because it was the student's decision whether to enroll in classes and have the funds applied towards tuition or to withdraw from the program and have the funds refunded directly to him or her.")).

The significance of the entitlement to a refund is underscored by *Custom Contractors*, *supra*, in which a bankruptcy trustee sued to recover estimated-income-tax payments from the IRS. In that case, the debtor, a limited-liability company, made several payments to the IRS to cover its sole member's estimated income tax. 745 F.3d at 1345 & n.1. But in the end, the member ended up not owing any income tax, and the IRS thus issued him—not the debtor—a refund of the payments made. *Id.* at 1345. In its analysis, the Eleventh Circuit noted that "[a]t no point did [the member] *actually* owe income taxes." *Id.* at 1351. "When the Debtor made

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the transfers to the IRS, it likely expected that [the member] would accrue tax liability . . . [b]ut, because that expectation was never realized, the IRS was always subject to the looming possibility that . . . the funds [would] be refunded to [the member]." *Id.* Accordingly, the court concluded that "the IRS, like [a] bank holding a deposit, cannot be held liable as an initial transferee." *Id.*

There was no suggestion in *Custom Contractors* that the IRS had held the funds in any sort of account accessible only to the member; rather, "the IRS deposited the funds in the general treasury, commingled them with other government funds, and spent them" (*id.*). Nevertheless, the court ruled that the transfer was "sufficiently similar to the deposit of funds into a bank account to conclude that the IRS acted as a mere conduit." *Id.* at 1352. The lesson of *Custom Contractors* is that it is not the existence of the "student accounts" that protects the schools in this appeal, but instead the undisputedly real obligation of the schools to refund tuition payments to the debtor's children in the event that the children withdrew from classes. *Cf. id.* at 1351 ("Strings were always attached to the transfer . . . .").

In contrast, *Perrino v. Salem, Inc.*, 243 B.R. 550 (D. Me. 1999), shows that the children would not have been initial transferees, despite the student accounts in their names, if they had had no right to a refund of the transferred money. In *Perrino*, a debtor purchased from a bank a cashier's check, made out to a third party, with an automobile dealership listed "on the face of the cashier's check," as if the dealership had purchased the check itself. *Id.* at 552-53. The debtor then gave the check to the dealership, which in turn delivered it to the check's designated payee in exchange for a vehicle. *See id.* at 553. In reversing the bankruptcy court's determination that the dealership was the initial transferee of the money, the district court observed that the dealership had no way of turning the check into cash. *See id.* at 560-61. Indeed, it "could not have done anything else with the cashier's check other than to exchange

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it" with the payee. *Id.* at 561. Particularly salient here, the bankruptcy court in *Perrino* had assumed that the bank "would be obligated to give [the dealership] the funds represented by the check if [the dealership] elected not to purchase the [vehicle] from [the payee]." *Id.* at 561 n.7. In reversing, the district court noted that even if the cashier's check could have been revoked—which the district court found doubtful—"the funds would have been credited to [the debtor's] account over which [the dealership] had no control," not to the dealership. *Id.*

Here, unlike in *Perrino*, the debtor's children were not required to use the money transferred by their father to pay for tuition; they could have withdrawn from school and taken the money themselves, to do with as they wished. The schools would have refunded the money to them, not to the debtor. It is for that reason—not because the schools routed tuition payments through "student accounts"—that, with respect to the refundable tuition payments, the bankruptcy court correctly determined that the debtor's children were the initial transferees.

3. The timing matters.

The schools' position, of course, is that the bankruptcy court's ruling was correct as to *all* the tuition payments, whenever made. Indeed, Hofstra and Fairfield argue that the timing of the debtor's payments is "irrelevant." Hofstra Br. 30; Fairfield Br. 27. In support, they point to language in *Custom Contractors* saying that "the timing of the transfers has no impact on the IRS's rights or obligations because no matter how much time passes between the transfers, the IRS can never be conceived of as a creditor." 745 F.3d at 1352; *see* Hofstra Br. 31; Fairfield Br. 27. But the schools misunderstand the Eleventh Circuit's ruling. The court in *Custom Contractors* was distinguishing its factual scenario, discussed earlier in this opinion, from the facts of *Nordberg v. Societe Generale (In re Chase & Sanborn Corp.)*, 848 F.2d 1196 (11th Cir. 1988),

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in which the timing of transfers was integral to determining whether a debt had been incurred:[11]

The debtor in *Societe Generale* wired money from its Crédit Lyonnais bank account to another corporation's Société Générale bank account so that a check that had been recently drawn on the Société Générale account would clear. *See id.* at 1198. By the time the wire transfer arrived, however, Société Générale had already honored the check because Crédit Lyonnais had assured it that the money was on the way. *See id.* On those facts, the court ruled that Société Générale was a mere conduit of funds that were transferred from the debtor to the payee of the check. *See id.* at 1201. Although technically Société Générale received the transfer from the debtor *after* it honored the check, the court determined that "the transaction was effectively simultaneous," because Société Générale "knew with absolute certainty that Credit Lyonnais[ ] had wired enough money to cover the check" and thus Société Générale was not a creditor in any real sense. *Id.*

As the *Custom Contractors* court explained, "[i]n *Societe Generale*, . . . the timing of the transfers was integral to the determination that the bank and the debtor did not enter into a debtor-creditor relationship." 745 F.3d at 1351. Specifically, if the court had considered the transfer *to* Société Générale "as actually and effectively occurring later in time than" the transfer *from* Société Générale, then the latter transfer "could have been characterized as a loan, and the [former] transfer could have been characterized as payment of a debt," thereby rendering Société Générale an initial transferee. *Id.* at 1351-52. By contrast, in *Custom Contractors*, the timing of the payments was irrelevant because "[a]t no point" in that case did the member "*actually* owe" anything to the IRS. *Id.* at 1351.

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In this appeal, however, timing is everything. Once the deadline to withdraw from school had passed, the schools were actually owed tuition—they were creditors. That neither the schools nor the debtor's children were creditors *of the debtor* (*cf.* Fairfield Br. 27; Hofstra Br. 31) is irrelevant. And once the schools received the tuition that they were owed, it was theirs to do with as they wished; at no time could an obligation to refund that money to the debtor's children have arisen. *Cf. Custom Contractors*, 745 F.3d at 1350 ("[F]unds received as payment of a debt leave the recipient with no obligations; that is, the transferee receives them with no strings attached."). Hence, as to any nonrefundable payments by the debtor, the schools were the initial transferees. *See, e.g.*, *Warnaco*, 2006 WL 278152, at *7 (ruling that company that received "reimbursement" for payments already made was "an initial transferee" because it was "a creditor and not a conduit").[12]

C. The bankruptcy court's ruling is unsupported by the record.

The bankruptcy court did not discuss the timing of the tuition payments in detail. Rather, it simply found that the schools "did not exercise dominion and control over the tuition payments at the time . . . the Debtor made the transfers" because "the [schools] [were not] authorized to utilize the funds" at that time. Appellant App. Pt. I, at TA0016.

And the bankruptcy court stated that if one of the debtor's children "decided to withdraw from [his or her] program, the student, and not the Debtor or the [school], [would be] entitled to any funds remaining in the account." *Id.* at TA0016. On that basis, the bankruptcy court determined that the debtor's children were the initial transferees and that the schools, "as subsequent transferees," could "assert the good faith defense provided by § 550(b)." *Id.* at TA0018.

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In so finding, the bankruptcy court appears to have assumed that all the debtor's payments were made early enough to be refundable. *See* Appellant Br. 22. Insofar as that assumption is correct, I would affirm the bankruptcy court's ruling. But as the trustee observes, "there was no evidence in the record to support this finding." *Id.* Indeed, neither Fairfield nor Hofstra even argue to the contrary.[13] And Brooklyn Law states that *one payment*, of $4578.00, was refundable—but it remains silent as to the rest of the $27,692.42 that it received (*see* Brooklyn Br. 5-6, ECF No. 8), tacitly suggesting that most of the tuition that the debtor paid to Brooklyn Law was nonrefundable. What is more, although the record appears to reflect a largely semiannual, July/December schedule of likely refundable payments to the schools, the record also contains evidence of several payments that at least *appear* to have been nonrefundable. *Compare*, *e.g.*, Appellant App. Pt. II, at TA0254 (showing tuition payment made to Hofstra on October 5, 2015), *with Fall 2015 Academic Calendar and Deadlines*, Hofstra U., http://web.archive.org/web/20161104150636/https://www.hofstra.edu/studentaffairs/studentservices/academicrecords/academic-records-fall-2015-calendar.html (archived Nov. 4, 2016) (indicating that "100% Tuition refund" was available only until September 8 and that "25% Tuition refund" was available only until September 29).[14]

Because the refundability of the payments affects the initial-transferee determination, I must remand these cases to the bankruptcy court for further factual development.

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CONCLUSION

In sum, I agree with the bankruptcy court's reasoning as to *refundable* payments made by the debtor. But because the record does not support a conclusion that all the payments in these cases were refundable, I vacate the decision of the bankruptcy court and remand these cases for further proceedings consistent with this opinion.[15]

So ordered.

/s/__________
Allyne R. Ross
United States District Judge

Dated: January 4, 2019
Brooklyn, New York

Footnotes:

[1.] An earlier version of this opinion could have been read to imply a factual finding that was not intended. This opinion has been amended to clarify any ambiguity as to my decision.

[2.] All citations of the form "ECF No. ___" pertain to the lead docket in this consolidated appeal, No. 1:18-CV-2204.

[3.] The trustee asserts, and Fairfield disputes, that another tuition payment to Fairfield, of $22,715, made in July 2014, also effectively came from the debtor. *See* Appellant App. Pt. I, at TA0008; Appellant App. Pt. IV, at TA0663. That issue can be explored, as necessary, by the bankruptcy court on remand.

4. The trustee sought to avoid as constructively fraudulent transfers the tuition payments made before the debtor filed for bankruptcy and as unauthorized postpetition transfers the tuition payments made after the debtor filed for bankruptcy. *See* Appellant App. Pt. I, at TA0004.

5. Because it found that the schools were completely protected by § 550, the bankruptcy court did not reach the question whether the debtor received "fair consideration for the [prepetition] tuition payments" (*id.*; *see also* N.Y. Debt. & Cred. Law § 273-a) or the question whether "the post-petition tuition payments . . . were unauthorized post-petition transfers of property of the estate" (Appellant App. Pt. I, at TA0004; *see also* 11 U.S.C. § 549). Nor have those questions been briefed here.

6. Because "the facts and legal arguments are adequately presented in the briefs and record," I find that "the decisional process would not be significantly aided by oral argument" (Fed. R. Bankr. P. 8019(b)(3)).

7. The statute also allows for recovery from "the entity for whose benefit [the] transfer was made" (§ 550(a)(1)), but the trustee does not argue that the schools can be classified as such (*see* Reply Br. 15, ECF No. 12).

8. The trustee's subsequent assertion that "the Debtor limited his children's right to use the Tuition Payments for any purpose other than paying tuition" (Reply Br. 10) is conclusory and unsupported in the record.

9. The trustee asserts, without support, that *"Whitlock* does not represent the law in the Second Circuit" (Reply Br. 9). I find no basis to conclude that there is a split of authority between the Fifth and Second Circuits on this issue. *Cf. Nisselson v. Salim (In re Big Apple Volkswagen, LLC)*, No. 11-2251 (JLG), 2016 WL 1069303, at *17 (Bankr. S.D.N.Y. Mar. 17, 2016) ("[W]hen courts speak of a party's lack of dominion and control over transferred assets, the focus is on whether the transferee has the legal right to put the assets to its own use—not whether the transferee had the right to do so but chooses not to exercise it.").

10. The money was routed through the church, rather than given directly to the nonprofit, for tax purposes. *See Engler*, 497 B.R. at 127.

11. *Societe Generale*, like *Bonded* itself, was cited with approval by the Second Circuit when it adopted the "mere conduit" test. *See Finley*, 130 F.3d at 58.

12. Before the bankruptcy court, the schools raised a number of arguments why, even if they are considered initial transferees, they would still not be liable to the trustee. *See* Appellant App. Pt. I, at TA0004-05. The bankruptcy court did not reach those issues (*see id.* at TA0014), and they were not raised on appeal, so I leave them to the bankruptcy court to address, as necessary, in the first instance.

13. Rather, they assert that the timing of the payments "is irrelevant." Hofstra Br. 30; *accord* Fairfield Br. 27 ("[T]he timing is legally irrelevant."). *But see supra* Section B.3.

14. I am not now determining whether this or any payment was in fact nonrefundable, nor am I relying on this or any party's website to reach any conclusions (*cf. Braun v. United Recovery Sys., LP*, 14 F. Supp. 3d 159, 169 (S.D.N.Y. 2014) (discussing propriety of taking judicial notice of contents of party's website)). I simply find that, with the exception of the single payment to Brooklyn Law already mentioned, the record is silent as to whether the debtor's tuition payments were refundable or nonrefundable and that, viewing the facts in the light most favorable to the trustee, any implicit finding by the bankruptcy court that *every* tuition payment was refundable is not supported by the record.

[15.] The previous version of this opinion could have been read to suggest that I had found that registration for classes marked the point after which any payments would be nonrefundable. *See* Mot. for Rehr'g 2-3, ECF No. 15. As should now be clear, I make no finding as to when each school's tuition payments were refundable or nonrefundable. That factual question was not briefed on appeal, and I express no opinion on it.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT
HARTFORD DIVISION

IN RE: **MICHAEL HAMADI AND MIRNA Y. HAMADI,** **DEBTORS.**	))))))	**CASE NO.** **CHAPTER**	**16-20653 (JJT)** **7**
BONNIE C. MANGAN, CHAPTER 7 TRUSTEE, **PLAINTIFF** **V.** **UNIVERSITY OF CONNECTICUT,** **DEFENDANT.**	)))))))))	**ADV. PRO. NO.** **RE: ECF NOS.**	**17-02090 (JJT)** **1, 15, 16, 20, 21, 27, 35**

APPEARANCES

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MEMORANDUM OF DECISION GRANTING IN PART AND DENYING IN PART UCONN'S MOTION FOR SUMMARY JUDGMENT

I. INTRODUCTION

Avoidance actions involving debtors making tuition payments on behalf of their children are currently percolating all throughout the United States bankruptcy and district courts.[1] The Defendant, the University of Connecticut ("UConn"), asks this Court to grant its Summary Judgment Motion ("Motion," ECF No. 15), dismissing the Complaint (ECF No. 1) filed by Bonnie C. Mangan ("Chapter 7 Trustee") in this Chapter 7 avoidance action. Pursuant to 11 U.S.C. §§ 548, 550, and 551 of the Bankruptcy Code, the Chapter 7 Trustee seeks to recover as constructive fraudulent transfers certain payments made by Michael Hamadi ("Debtor Husband") and Mirna Y. Hamadi (collectively, "Debtors") to UConn for college tuition and fees paid on behalf of their adult son Ali Hamadi ("Ali"). For the reasons stated herein, the Motion is **GRANTED** in part and **DENIED** in part.

II. JURISDICTION

This Court has jurisdiction under 28 U.S.C. § 1334(b) and may hear and determine this matter pursuant to the District Court's General Order of Reference dated September 21, 1984. UConn filed the instant Motion in this adversary proceeding, which the Chapter 7 Trustee asserts

[1] This is not the first time this Court has seen a trustee attempt to recover tuition payments a debtor parent made to a university on behalf of adult children. *See, e.g.*, *Novak v. Univ. of Miami (In re Demitrus)*, 586 B.R. 88 (Bankr. D. Conn. 2018); *Boscarino v. Bd. of Trs. of Conn. State Univ. Sys. (In re Knight)*, No. 15-21646 (JJT), 2017 WL 4410455 (Bankr. D. Conn. Sept. 29, 2017). *In re Knight* questioned whether the debtor parent received reasonably equivalent value in exchange for the tuition payments she made on her adult son's behalf. *See also Chorches v. Catholic Univ. of Am.*, No. 3:16-cv-1964 (MPS), 2018 WL 3421318, at *4 (D. Conn. July 13, 2018) (quoting *In re Knight*, 2017 WL 4410455, at *3, *6). The Court has also addressed state sovereign immunity in tuition claw back cases. *See In re Knight*, 2016 WL 6134143, at *2 (Bankr. D. Conn. Oct. 20, 2016). Courts throughout the country have seemingly struggled with the appropriateness of avoidance claims in this context, absent actual fraud, and Congress has noticed. *See, e.g.*, Jenna C. MacDonald, *Out of Reach: Protecting Parental Contributions to Higher Education from Clawback in Bankruptcy*, 34 Emory Bankr. Dev. J. 243 (2017); Andrew Mackenzie, *The Tuition "Claw Back" Phenomenon: Reasonably Equivalent Value and Parental Tuition Payments*, 2016 Colum. Bus. L. Rev. 924, 935 (2016). Absent a legislative fix, the Courts will continue to wrestle with the conundrums presented by these types of cases.

is a core proceeding pursuant to 28 U.S.C. §§157(b)(2)(A) and (H).[2] Venue is proper under 28 U.S.C. § 1409(a).

III. FACTUAL BACKGROUND

The Court notes the following undisputed material facts.

The Debtors filed a voluntary petition (Case No. 16-20653 (JJT), ECF No. 1) for Chapter 7 bankruptcy protection on April 26, 2016 ("Petition Date"). Def.'s D. Conn. L. Civ. R.56(a)(1) Statement ¶ 1, ECF No. 16; Pl.'s D. Conn. L. Civ. R. 56(a)(2) Statement ¶ 1, ECF No. 21. On December 14, 2017, the Chapter 7 Trustee commenced this adversary proceeding by filing the Complaint.

Ali is the Debtors' son, who was an adult at all times relevant to this adversary proceeding. Def.'s Statement ¶ 3; Pl.'s Statement ¶ 3. Ali enrolled as an undergraduate student at UConn from August 2014 through September 2016. Def.'s Statement ¶ 4; Pl.'s Statement ¶ 4. UConn received tuition payments and fees in exchange for providing the value of a college education to Ali. Def.'s Statement ¶ 14; Pl.'s Statement ¶ 14.

UConn bills each of its students for tuition, fees, and expenses through an online portal called the Student Administration System ("Online Portal"). Def.'s Statement ¶ 5; Pl.'s Statement ¶ 5. UConn maintains the Online Portal, and every student possesses a unique NetID and password, giving him access to the Online Portal. Def.'s Statement ¶ 6; Pl.'s Statement ¶ 6. UConn treats every payment to a student's account as credit belonging to the individual student, rather than the third-party individual who made the payment on the student's behalf. Def.'s Statement ¶ 11; Pl.'s

[2] Although the Court treats the present matter as a core proceeding pursuant to 28 U.S.C. §§ 157(b)(2)(A) and (H), the fraudulent transfer claim likely presents a *Stern* claim, depriving this Court of constitutional jurisdiction to enter final judgment. *See generally Stern v. Marshall*, 564 U.S. 462 (2011); *see also Exec. Benefits Ins. Agency v. Arkison*, 573 U.S. 25, 37 (2014). UConn denied this Court's authority to enter final judgment over the matter in its Answer to the Complaint ("Answer," ECF No. 11). In the event that this Decision is appealed to the District Court, then it may treat this Decision as proposed findings of fact and conclusions of law. Fed. R. Bankr. P. 8018.1.

Statement ¶ 11. If a student chooses to enroll in university classes at UConn, UConn thereafter retains the money paid and applies it to the student's tuition bill. Def.'s Aff. ¶ 9, ECF No. 15-2; Def.'s Statement ¶ 12; Pl.'s Statement ¶ 12. If a student chooses not to register for classes or withdraws from UConn, then UConn issues a refund directly to the student, regardless of who paid the money to the student account.[3] Def.'s Aff. ¶ 10; Def.'s Statement ¶ 13; Pl.'s Statement ¶ 13.

Ali held his student account ("Account") in the Online Portal in his name only. Def.'s Statement ¶ 7; Pl.'s Statement ¶ 7. The Debtors exerted no ownership or control over his Account and did not have any rights in or to the Account. Def.'s Statement ¶ 7; Pl.'s Statement ¶ 7. In the two years preceding the Petition Date, the Debtor Husband made four electronic payments to Ali's Account through the Online Portal.[4] Def.'s ¶ 8; Pl.'s ¶ 8. UConn retained and applied each of the pre-petition payments to Ali's tuition bill when he registered for 2014 fall semester, 2015 spring semester, and 2016 spring semester classes. Def.'s Statement ¶ 12; Pl.'s Statement ¶ 12. Although the payments made on August 25, 2014 and January 20, 2015 would have entitled Ali to a full refund, he would have only been entitled to a 90% refund on January 22, 2016 and a 25% refund on February 15, 2016 if he decided not to register for classes or to withdraw from UConn ("Refundable Payments"). *See* Def.'s Suppl. Aff. ¶ 5. Ali would have been unable to receive a refund for the remaining 10%, totaling $636.35, and 75%, totaling $2,393.81, respectively, even if he withdrew from UConn or did not enroll in classes ("Nonrefundable Payments"). *See id.* After the Petition Date, on September 1, 2016, the Debtor Husband made three additional electronic

[3] UConn administers refunds under a policy based upon the date the student withdraws. Def.'s Suppl. Aff. ¶ 4, ECF No. 35. Although a student is entitled to a 100% refund if he withdraws on the first day of classes, he is only entitled to a 90% refund if he withdraws during the first week of classes, a 60% refund if he withdraws during the second week of classes, a 50% refund if he withdraws during the third or fourth week of classes, and a 25% refund if he withdraws between the fifth and eighth week of classes. *Id.* at ¶ 5.

[4] The Debtor Husband made the following four pre-petition payments: 1) $3,922.00 on August 25, 2014; 2) $6,751.00 on January 20, 2015; 3) $6,363.50 on January 22, 2016; and 4) $3,191.75 on February 15, 2016, totaling $20,228.25. Def.'s Statement ¶ 8; Pl.'s Statement ¶ 8.

payments totaling $3,426.75 into Ali's Account via the Online Portal ("Post-Petition Payments"). Def.'s Statement ¶¶ 9–10; Pl.'s Statement ¶¶ 9–10.

UConn accepted the Refundable Payments and Nonrefundable Payments in good faith. Def.'s Statement ¶ 15; Pl.'s Statement ¶ 15. UConn only first learned that the Refundable Payments, Nonrefundable Payments, and Post-Petition Payments were in dispute in February 2017 when it received a demand letter from the Chapter 7 Trustee. Def.'s Statement ¶ 16; Pl.'s Statement ¶ 16.

In connection to this Motion, UConn submitted the Affidavit of Margaret Selleck, UConn's Bursar ("Affidavit," ECF No. 15-2). UConn also filed the Supplemental Affidavit in Support of the Motion sworn to by Nicole LeBlanc, Associate Bursar for UConn ("Supplemental Affidavit," ECF No. 35). The Chapter 7 Trustee does not dispute that the payments made to Ali's Account were treated according to the school policies laid out in the Affidavit and Supplemental Affidavit.

IV. DISCUSSION

A. Summary Judgment Standard

It is well settled that summary judgment is "an integral part of the Federal Rules as a whole, which are designed 'to secure the just, speedy[,] and inexpensive determination of every action.'" *Celotex Corp. v. Catrett*, 477 U.S. 317, 327 (1986) (quoting Fed. R. Civ. P. 1). The Court shall grant a summary judgment motion if "the movant shows that there is no genuine dispute as to any material fact." Fed. R. Civ. P. 56(a); *see also* Fed. R. Bankr. P. 7056. The burden is on the moving party, and the facts "must be viewed in the light most favorable to the opposing party." *Tolan v. Cotton*, 572 U.S. 650, 657 (2014) (internal quotations and citations omitted). When ruling on motions for summary judgment, "the judge's function is not himself to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial." *Anderson v. Liberty Lobby*, 477 U.S. 242, 249 (1986).

B. Constructive Fraudulent Avoidance Claims Asserted in the Complaint

The Court is tasked with determining whether there is a genuine issue of material fact regarding the alleged constructive fraudulent conveyances preventing the Court from granting summary judgment in UConn's favor. The Chapter 7 Trustee bases her claims against UConn on 11 U.S.C. §§ 548(a)(1)(B), 550, and 551. Noticeably absent in the Chapter 7 Trustee's Complaint is any claim under 11 U.S.C. § 549 to avoid the Debtor Husband's Post-Petition Payments. UConn seeks summary judgment on all claims.

UConn asserts two defenses in its Motion: 1) that Ali was the initial transferee of the tuition payments, and pursuant to 11 U.S.C. § 550(b)(1), UConn acted as Ali's immediate transferee when it received the tuition payments, which it took for value, in good faith, and without knowledge of the voidability of the transfers, and 2) that any tuition payments made on September 1, 2016 occurred post-petition. The Chapter 7 Trustee counters in her Memorandum of Law in Opposition to the Motion ("Opposition Memo," ECF No. 20) that UConn is an initial transferee because it exercised dominion and control over the monies once the Debtor Husband deposited them into Ali's Account. The Chapter 7 Trustee does not raise material issues of fact relating to the 11 U.S.C. § 550(b)(1) good faith defense.

After reviewing the Motion, the parties' Local Rule 56(a) Statements, the Opposition Memo, UConn's Reply to the Opposition Memo (ECF No. 27), the Affidavit, and the Supplemental Affidavit, this Court finds and adjudges that: 1) UConn is both an initial transferee and an immediate transferee under 11 U.S.C. § 550(a), depending on the transfer date of the tuition payments; 2) UConn has established the elements of a good faith defense under 11 U.S.C.

§ 550(b)(1) as an immediate transferee; and 3) the Post-Petition Payments are not avoidable or recoverable under 11 U.S.C. §§ 548 or 550.

C. Payment Timing Determines UConn's Status as an Initial Transferee or Immediate Transferee of Such Initial Transferee.

To determine the status of an initial transferee, the Second Circuit has adopted the "mere conduit" test in *Christy v. Alexander & Alexander of N.Y. Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey)*, 130 F.3d 52, 58 (2d Cir. 1997). To qualify as an initial transferee, "the minimum requirement . . . is dominion over the money or other asset, the right to put the money to one's own purposes." *Id.* at 57 (citation omitted). "[A] commercial entity that, in the ordinary course of its business, acts as a mere conduit for funds and performs that role consistent with its contractual undertaking in respect of the challenged transaction, is not an initial transferee within the meaning of § 550(a)(1)." *Id.* at 59. A trustee may recover the value of property transferred and avoidable under 11 U.S.C. § 548 from either the initial transferee of the property or the immediate transferee of such initial transferee. 11 U.S.C. § 550(a).

Under applicable law, by their nature, form, and substance, the Refundable Payments for tuition and fees do not constitute recoverable transfers of property as defined under 11 U.S.C. § 550. The recent decision by Chief Judge Carla E. Craig in *Pergament v. Hofstra Univ.* (*In re Adamo)*, 582 B.R. 267 (Bankr. E.D.N.Y. 2018), *vacated and remanded on other grounds sub nom. Pergament v. Brooklyn Law Sch.*, No. 1:18-CV-2204 (ARR), 2019 WL 111044 (E.D.N.Y. Jan. 4, 2019), is otherwise fully dipositive of this issue and supports the aforesaid finding. Although Chief Judge Craig's decision was vacated and remanded by the District Court for a factual issue regarding payment timing, the District Court otherwise upheld her reasoning as sound and agreed with her legal conclusion. *See Pergament v. Brooklyn Law Sch.*, 2019 WL 111044, at *1, *10. This

Court expressly adopts the reasoning of these two decisions, as applied below, as determinative of this Motion.

Although the Refundable Payments here were placed in an account maintained by UConn, they were ultimately property of Ali, and UConn did not immediately have the right to use the Refundable Payments for its own purposes. UConn essentially acted as a financial institution or intermediary by maintaining the Online Portal, which is akin to a financial institution maintaining a bank account. *In re Adamo*, 582 B.R. at 276. Under this arrangement, Ali was the initial transferee, and UConn served as a mere conduit who did not have dominion and control over the Refundable Payments until only thereafter accepting the tuition payments, as an immediate transferee, once Ali enrolled. The same however cannot be said for UConn's treatment of the Nonrefundable Payments.

Here, timing is everything. This Court appreciates the meticulousness required to uncover the factual timeline, as emphasized by the District Court in *Pergament v. Brooklyn Law Sch.*, 2019 WL 111044, at *9. "Once the deadline to withdraw from school had passed, the schools were actually owed tuition—they were creditors. That neither the schools nor the debtor's children were creditors *of the debtor* is irrelevant." *Id.* At the point UConn no longer had any obligation to refund the payments to Ali, it exercised complete dominion and control over the nonrefundable portion of the Debtors' payments. The timing and nature of the Debtor's Nonrefundable Payments to the Account qualified UConn as an initial transferee. *See, e.g., Authentic Fitness Corp. v. Dobbs Temp. Help Servs., Inc. (In re Warnaco Grp., Inc.)*, No. 01 B 41643(RLB), 2006 WL 278152, at *7 (S.D.N.Y. Feb. 2, 2006) (holding that receiving reimbursement for payments makes a company an initial transferee because it was "a creditor and not a conduit"). As such, the Chapter 7 Trustee may be able to make a valid claim under the Bankruptcy Code with respect to the Nonrefundable Payments, subject to any defenses.

D. Initial Transferees and Immediate Transferees of Such Initial Transferees May Present Defenses Under the Bankruptcy Code.

i. Immediate Transferees' Protection Under 11 U.S.C. § 550(b)(1)

Under 11 U.S.C. § 550(b)(1), a trustee is prohibited from recovering from an immediate transferee of an initial transferee who "takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided[.]" This is a three-part test. The "good faith" prong is uncontested here, and the "without knowledge" component was ostensibly conceded by the Chapter 7 Trustee when she agreed that UConn only learned about the payments being in dispute in February 2017, well after UConn received the Refundable Payments in satisfaction of Ali's tuition obligations.

As for the "for value" piece, the Chapter 7 Trustee does not dispute that UConn provided value to Ali in exchange for the Refundable Payments. She also does not make any arguments that the Debtors must be the parties to receive value, and even if she did, the case law does not support such an outcome. As Chief Judge Craig laid out in her decision in *In re Adamo*, "[t]he statute does not say 'value to the debtor'; it says 'value'. . . . All of the courts that have considered this question have held or implied that value to the transferor is sufficient." 582 B.R. at 276 (quoting *Bonded Fin. Servs., Inc. v. Eur. Am. Bank*, 838 F.2d 890, 897 (7th Cir. 1988)).

Because there is no material dispute that UConn received the Refundable Payments in good faith, for value, and without knowledge, the Chapter 7 Trustee cannot demonstrate the requisite facts to support her claims under 11 U.S.C. §§ 548 and 550 regarding the Refundable Payments.

ii. Initial Transferees' Protections Under 11 U.S.C. § 548

Initial transferees are strictly liable under the Bankruptcy Code, unless other defenses can be interposed. *Carroll v. Tese-Milner (In re Red Dot Scenic, Inc.)*, 351 F.3d 57, 58 (2d Cir. 2003). In its Motion, UConn expressly reserved its rights to assert defenses under 11 U.S.C. § 548. As UConn asserted in its Answer, a transfer may give UConn a lien where it can show that the transfer was taken "for value and in good faith[.]" 11 U.S.C. § 548(c). UConn also deliberately chose not to raise an argument over reasonably equivalent value under 11 U.S.C. § 548(a)(1)(B)(i) in this Motion. Therefore, at this juncture, a genuine issue of material fact remains on the avoidability of the Nonrefundable Payments, subject to other defenses that UConn may still raise regarding its status as an initial transferee. Accordingly, summary judgment may not enter as to the Nonrefundable Payments.

E. Post-Petition Payments are Not Subject to Avoidance Under 11 U.S.C. § 548.

Lastly, the Chapter 7 Trustee concedes that the Post-Petition Payments occurred after the Petition Date. Nowhere in her Opposition Memo does she assert that the Post-Petition Payments are avoidable under 11 U.S.C. § 548, or otherwise. Thus, the Court grants summary judgment to UConn on the Post-Petition Payments because these transfers, by definition, are not subject to avoidance under 11 U.S.C. § 548. *In re Knight*, 2017 WL 4410455, at *2 ("Regardless of whether the material facts are undisputed, however, 'the court must determine whether the legal theory of the motion is sound.'") (quoting *Jackson v. Fed. Exp.*, 766 F.3d 189, 194 (2d Cir. 2014)).

V. CONCLUSION

For the foregoing reasons, UConn's Motion is **GRANTED**, as it pertains to the Refundable Payments and Post-Petition Payments and **DENIED**, as it pertains to the Nonrefundable Payments because genuine issues of material fact exist.

The parties should consider whether supplemental summary judgment motions or a trial upon stipulated facts best addresses the remaining issue to be tried. The parties are directed to confer regarding the terms of a final pre-trial order, and the Clerk of Court shall schedule a status conference in February 2019 for the Court to consider the terms of the parties' proposed pre-trial order.

IT IS SO ORDERED at Hartford, Connecticut this 31st day of January 2019.

James J. Tancredi
United States Bankruptcy Judge
District of Connecticut

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT
HARTFORD DIVISION

IN RE:	)	CASE No.	19-20016 (JJT)
	)		
MARCUS LOPEZ EDWARDS, DEBTOR.	)	CHAPTER	11
	)	RE: ECF Nos.	12, 15, 29
T&M BUILDING CO., INC., MOVANT	)		
V.	)		
MARCUS LOPEZ EDWARDS, RESPONDENT.	)		

BENCH RULING ON MOTION FOR RELIEF FROM STAY AND IN REM RELIEF

Before the Court is T&M Building Company, Inc.'s ("Movant") Motion for Relief from the Automatic Stay and In Rem Relief ("Motion," ECF No. 12). After previously hearing the arguments from the Movant and the debtor, Marcus Lopez Edwards ("Debtor"), the Court denied the Motion "as a preliminary matter and without prejudice, in order for the Court to further assess the filing of any bona fide plan and offers of adequate protection by the debtor and to re-examine the weight and demonstration of the asserted good cause in [a] final hearing[,]" for which the parties were instructed to prepare and present evidence (ECF No. 29). The Motion was scheduled for final arguments and hearing before this Court on March 26, 2019 (ECF No. 35).

The Debtor resists stay relief with a proposed Chapter 11 plan to fully pay approximately $900,000.00 on the Movant's matured Note and Mortgage on his house, the Debtor's principal residence, that the Superior Court and the parties have valued at $352,000.00. He would do so over a ten-year period at an interest rate of 6 percent, with monthly payments of $7,550.00, and provide interim adequate protection payments of $2,356.23 per month until Confirmation. This

Chapter 11 Plan follows two previously failed or dismissed bankruptcy filings by the Debtor (Docket Nos. 16-21694 and 17-20768); a previously filed Chapter 7 case (Docket No. 18-20560), in which the Debtor received a discharge on September 14, 2018; and the previously dismissed Chapter 13 case of the Debtor's spouse, Melody T. Edwards (Docket No. 18-21020)—all within the last two-and-a-half years. All of these filings were commenced on the eve of foreclosure sales, the running of law days, or the vesting of title so as to frustrate remedies by the Movant in a related foreclosure proceeding in the Superior Court, based upon the Movant's construction loan to the Debtor and his wife, which was commenced in 2015.

Through claimed misfortunes, advice of counsel, unemployment, and non-responsiveness to deficiency notices of this Court, the Debtor and his spouse have successfully impaired, frustrated, and delayed the Movant at many turns for many years. During that time, they lived in the home having made only five total mortgage payments, with two of those made since the commencement of this case.

On the basis of recent and substantial improvements of their income driven by Mrs. Edwards's new job and the Debtor unrelentingly work as a nurse at several healthcare facilities throughout Greater Hartford, averaging eighty hours per week, the Debtor would have the Court believe that the Debtor is reformed, that the Debtor's finances are sufficiently enhanced, and that the Debtor's proposed plan will fully protect and compensate the Movant. The Debtor's vision of how he will retain his home, however, is unsustainable, improvident, infeasible, impractical, and prohibited by law. The Debtor's course of resilience and perseverance have heretofore accomplished the retention of the family home, but not upon good faith efforts to restructure or address their defaults, and, in this instance, absent earnest compliance with obligations under the Bankruptcy Code.

In a word, the Debtor's proposed Chapter 11 plan is patently unconfirmable under 11 U.S.C. §§ 1123 and 1129. Specifically: (1) the plan, premised upon the Debtor's super-human ability to work eighty hours per week for ten years, is unsustainable as a practical, logical, and financial matter and it will fail because the Debtor is human and life's demands will call for even more monies for cars, maintenance, healthcare, child upbringing, living expenses, vacations, and the like; (2) the plan's objective of saving a $352,000.00 home by paying $900,000.00 is improvident, foolish, and unreasonable; (3) the Note and Mortgage modifications (rejected by the Movant) called for in the proposed plan are expressly prohibited under 11 U.S.C. § 1123(b)(5); and (4) the plan otherwise cannot satisfy 11 U.S.C. §§ 1129(a)(1), (2), (3), (7), and (11).

On account of the Debtor's and his spouse's serial filings and pattern of delay, frustration, and abuse of the bankruptcy process, this Court, for cause shown, also orders the In Rem relief requested by the Movant. Accordingly, the Motion is granted under 11 U.S.C. §§ 362(d)(1) and (4), and the fourteen-day stay of this ruling is appropriately lifted or waived so that the Movant, in the interests of justice, may proceed with all deliberate speed to enforce its foreclosure remedies.

IT IS SO ORDERED at Hartford, Connecticut this 29th day of March 2019.

James J. Tancredi
United States Bankruptcy Judge
District of Connecticut

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT
HARTFORD DIVISION

IN RE:	:	**CHAPTER 13**
	:	
VALERIE I. CARLSEN,	:	**CASE NO. 19-20366 (JJT)**
DEBTOR.	:	
	:	**ECF NOS. 7, 17**

RULING ON DEBTOR'S MOTION FOR RELIEF FROM *IN REM* ORDER

After notice and the evidentiary hearing held on March 14, 2019, where the record and the parties' arguments have been fully examined, the Court denies the Motion for Relief from *In Rem* Order ("Motion," ECF No. 7) filed by Valerie I. Carlsen ("Debtor") and sustains the Town of East Windsor's Objection (ECF No. 17).

The Debtor has filed four prior bankruptcies. *See* ECF No. 10. The Debtor filed the current Chapter 13 bankruptcy case on March 8, 2019, after a foreclosure sale at her residential property, but before the Superior Court decided the motion to approve the prevailing bid at such sale at a hearing scheduled for March 18, 2019. In the Motion, the Debtor claims that neither Attorney Andrew Amendola nor Attorney Michael Habib (collectively, "previous lawyers") had her signature or her authority to file the third and fourth petitions for bankruptcy relief in Case No. 17-21485 and Case No. 18-20108, respectively. She asserts there is good and sufficient cause to vacate the Amended Order Granting Relief from the Automatic Stay with *In Rem* Relief entered on February 13, 2018 in the fourth case ("*In Rem* Order," ECF No. 19 in Case No. 18-20108), so as to stay the Superior Court hearing scheduled for March 18, 2019 and to allow her to propose a Chapter 13 plan in her newly filed fifth bankruptcy proceeding.

The Motion raises grave issues about the integrity of the prior bankruptcy filings and the professional propriety of the various acts of her previous lawyers involved in those proceedings. Notwithstanding the testimony of the Debtor and her daughter adduced to support her Motion, the Court denies the relief requested for the following reasons:

1. In light of the conflicting testimony, the Debtor has failed in her burden of proof to demonstrate good cause to vacate the *In Rem* Order.
2. The Debtor, having availed herself of the protections of the third and fourth bankruptcy filings, secured the stay of imminent foreclosure sales on her property, indisputably consistent with her goals communicated to Attorney Amendola, and having secured a Certificate of Credit Counseling in the fourth bankruptcy case (*see* ECF No. 30 in Case No. 18-20108) and previously filed a motion to reopen the fourth bankruptcy case and vacate the *In Rem* Order (ECF No. 30 in Case No. 18-20108), which this Court subsequently denied for intent to hinder and delay through an abuse of the automatic stay (ECF No. 32 in Case No. 18-20108), the Court finds that her testimony regarding her lack of knowledge of the prior bankruptcy proceedings and their effects and due authorization is simply not credible.[1]
3. The Debtor, having obtained the aforesaid goals and benefits of the automatic stay in the disputed bankruptcy filings, impliedly consented and effectively ratified and confirmed the third and fourth bankruptcy proceedings by both her actions and acquiescence.

[1] Remarkably, while the Debtor feigns blindness to the prior bankruptcy proceedings, she was served with the previous motion to vacate the *In Rem* Order, filed on her behalf, by first-class mail at the same residential address listed on her fourth and current bankruptcy petitions, as evidenced by the certificate of service (ECF No. 30 in Case No. 18-20108). Regarding the fourth bankruptcy case alone, based on the notices of mailing and certificates of service of record, the Debtor was also sent the deficiency notice and notice of dismissal by first-class mail (ECF No. 7 in Case No. 18-20108), the Town of East Windsor's previous motion for relief from stay by regular mail and FedEx tracking (ECF No. 14 in Case No. 18-20108), the *In Rem* Order by first class mail (ECF No. 21 in Case No. 18-20108), and the order dismissing the fourth bankruptcy case by first class mail (ECF No. 24 in Case No. 18-20108).

4. The Debtor, having obtained the aforesaid goals and benefits of the disputed bankruptcy filings on the eve of previously scheduled foreclosure sales, should be equitably estopped from assailing the legal authority, force, and effect of the third and fourth bankruptcy filings and the *In Rem* Order, so as to avoid further harm, detriment, injury, delay, and expense to the Town of East Windsor.
5. The Debtor and, on her account, her previous lawyers in the foreclosure, having failed to articulate any bona fide defense to the foreclosure should be equitably estopped from assailing the legal authority, force, and effect of the third and fourth bankruptcy filings and the *In Rem* Order, so as to avoid further harm, detriment, injury, delay, and expense to the Town of East Windsor.
6. The Debtor's failures, deficiencies, and course of conduct in each of the dismissed prior serial filings, the indefensible delays in the foreclosure, and her years of nonpayment of taxes demonstrate a lack of good faith or clean hands, which support the denial of the extraordinary relief requested herein.
7. The Debtor should be denied the relief requested herein on account of laches and on account of her undue, last minute delay in seeking relief from the *In Rem* Order. The Motion has sought expedited relief only now because a hearing to approve the foreclosure sale is scheduled in three days, notwithstanding that she had at least one year's advance knowledge of this Court's *In Rem* Order.

Accordingly, for the reasons stated herein, the Motion is **DENIED**, and the Objection is **SUSTAINED**. In the interests of fundamental fairness and justice, to the extent that the 14-day stay imposed by Fed. R. Bankr. P. 4001(a)(3) is applicable, it is waived, and the Town of East Windsor may immediately enforce and implement this Ruling.

IT IS SO ORDERED at Hartford, Connecticut this 15th day of March 2019.

James J. Tancredi
United States Bankruptcy Judge
District of Connecticut

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT
NEW HAVEN DIVISION

In re: MELISSA A. MARESCA. *Debtor.*	Case No.: 16-30755 (AMN) Chapter 7
MELISSA A. MARESCA, *Movant* v. TERRY DONOVAN, *Respondent*	Re: ECF Nos. 57, 59, 61, 62, 64, 65, 66, 67, 69, 71

MEMORANDUM OF DECISION AND ORDER GRANTING MOTION TO AVOID LIEN IMPAIRING EXEMPTION IN PROPERTY USED AS A RESIDENCE BY A DEPENDENT OF THE DEBTOR PURSUANT TO 11 U.S.C. §§ 522(d)(1) AND 522(f)(1)

Melissa A. Maresca ("Debtor"), filed a Chapter 7 petition on May 12, 2016 (the "Petition Date"). ECF No. 1. On November 4, 2017, the Debtor filed a motion to avoid the judicial liens of Attorney Terry Donovan and another creditor (the "Motion") because they allegedly impaired Ms. Maresca's exemption in real property used by her dependent child, periodically, pursuant to 11 U.S.C. § 522(f).[1] ECF No. 57. The real property in issue is known as 33 Laurel Road, Essex, Connecticut (the "Property"). ECF No. 57.

[1] Unless otherwise noted, all statutory citations refer to Title 11 of the United States Code, commonly referred to as the "Bankruptcy Code". ECF No. 57 is the Debtor's second motion to avoid a lien under § 522(f). Her first motion, ECF No. 9, was denied for failure to prosecute. ECF No. 56.

Terry Donovan ("Creditor"), the holder of the larger judicial lien[2] (the "Judicial Lien"), objected to the Motion.[3] ECF No. 59.

While the parties agree on many of the underlying facts relevant to this dispute, they do not agree as to the value of the Property on the Petition Date. The Debtor contends the value was $465,000.00, while the Creditor thinks a higher value of $560,000.00 should be found. *Compare,* ECF Nos. 66, 71. Because the court concludes that the Debtor may assert an exemption pursuant to 11 U.S.C. § 522(d)(1) in her interest in the Property premised on her dependent child's use of the Property as a residence, and in light of the undisputed outstanding mortgage debt that was senior in priority to the Judgment Lien on the Petition Date, the court need not resolve the parties' differences of opinion as to value.

Jurisdiction

This court has jurisdiction over this contested matter pursuant to 28 U.S.C. §§ 1334(b) and 157(b), and the United States District Court for the District of Connecticut's General Order of Reference dated September 21, 1984. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B), and the bankruptcy court has the power to enter a final judgment, subject to traditional rights of appeal. Venue is proper in this District. 28 U.S.C. § 1409.

Relevant Facts

[2] The Motion asserted the Creditor first recorded a judicial lien against the Property for $20,000.00 on October 13, 2013, and later recorded a second judicial lien against the Property for $70,943.40, that relates back in time to the attachment of the first judicial lien. ECF No. 57. In their joint stipulation of facts, the parties contend the Creditor holds one lien in the amount of $70,943.40. ECF No. 61, ¶ 21.

[3] Citibank, N.A., holder of another judicial lien in the amount of $3,024.36 encumbering the Property, did not file a response. As discussed more fully herein, the Debtor is entitled to avoid both the Citibank, N.A., judicial lien, and the Creditor's (Ms. Donovan's) lien under 11 U.S.C. § 522(f). Because Creditor's objection requires a more detailed analysis, this Memorandum of Decision refers only to her judicial lien encumbering the Property.

The parties – formerly attorney and client – agree on many of the material facts. ECF No. 61. Undoubtedly, the parties' former attorney-client relationship has deteriorated and the court is mindful that the state court has determined the attorney provided legal services to the client/Debtor in connection with her divorce for which compensation was due. The bankruptcy court's task here, however, is to determine the extent of the exemption provided by Congress to bankruptcy debtors having dependents who live in real property owned by the debtor but where the debtor may not reside, pursuant to 11 U.S.C. § 522(d)(1). It is with this focus that the court has considered the parties' argument and stipulation of facts.

The Debtor and her ex-husband jointly purchased the Property in 2005, incurring mortgage debt in the original amount of $436,000. ECF No. 61, ¶ 1-3. The ex-husband (who was then married to the Debtor) was the borrower on the mortgage loan note and both the Debtor and the ex-husband executed the mortgage. ECF No. 61, ¶ 4. At some point, a second mortgage was recorded against the Property and it appears undisputed that as of the Petition Date the total mortgage debt recorded against the Property – all being prior in interest to the Judgment Lien – was approximately $525,899.26. ECF No. 57, ¶ 3(a) and 3(b). Pursuant to the Debtor's bankruptcy schedules, she owned a two-thirds interest in the Property on the Petition Date.[4] ECF No. 1, p.10.

In 2011, the Debtor retained the Creditor as her attorney in a divorce action that resulted in the entry of a divorce decree in 2013. ECF No. 61, ¶ 11, 14. On the Petition Date, the Debtor's child ("Child") was a minor and a dependent of the Debtor. The divorce decree awarded "joint legal custody" of the Child to the Debtor and her ex-husband, "with

[4] *But see,* Note 6, hereafter. There is some confusion as to the percentage of the Property owned by the Debtor but it does not affect the overall analysis, as discussed later in this Memorandum of Decision.

the primary residence of [the Child] to be with" the Debtor. ECF No. 61, ¶ 15. Although the divorce decree contemplated the Property would be sold shortly after the divorce decree entered, the Debtor and the ex-husband agreed to modify the decree to delay the sale of the Property and those agreements were approved by the state court. ECF No. 61, ¶¶ 22, 25. On the Petition Date, the ex-husband resided at the Property while the Debtor resided in a rental apartment in another town. ECF No. 61, ¶¶ 22-27. Despite those modifications, the Child "spends time with both parents," and attends school in the town where the Property is located. ECF No. 61, ¶ 26, 28.

Prior to the Petition Date, the Creditor, Ms. Donovan, obtained a state court judgment against the Debtor for unpaid legal fees relating to the divorce proceeding in the amount of $70,943.00, which forms the basis for the pre-petition Judicial Lien in dispute here. ECF No. 61, ¶ 21.

Discussion

Section 522(d)(1) of the Bankruptcy Code provides, in pertinent part, that a debtor may claim an exemption in, "[t]he debtor's aggregate interest, not to exceed $23,675.00 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence . . ." 11 U.S.C. § 522(d)(1). Debtors filing bankruptcy may elect to exempt certain property under either a state law exemption scheme, or the exemptions provided in the Bankruptcy Code in § 522. Here, the Debtor elected to use the federal exemption scheme provided by the Bankruptcy Code, rather than the (perhaps) more generous State of Connecticut homestead exemption that may apply for up to $75,000 of value in a debtor's primary residence. *See*, Conn. Gen. Stat. § 52-352a.

The exemption available in § 522(d)(1), is commonly referred to as the "homestead" exemption, although the term "homestead" does not appear in § 522. See, 4 *Collier on Bankruptcy* ¶ 522.09 (16th ed. 2018). It is generally understood that § 522 is intended to protect a debtor's interest in her home from creditors, in order to "assist a debtor in keeping a roof over [her] head, and facilitate a Debtor's 'fresh start.'" *In re Brown*, 299 B.R. 425, 428 (Bankr. N.D.Tex. 2003). This understanding is consistent with the liberal construction of bankruptcy exemptions in favor of a debtor. *In re Wegrzyn*, 291 B.R. 2, 8-9 (Bankr. D. Mass. 2003). The text of § 522(d)(1) does not refer to a debtor's homestead; instead, it refers to a debtor's or a dependent of a debtor's "residence." The place where one "lives," or "resides" or is "domiciled," can be difficult to define. *In re Frame*, 120 B.R. 718, 723 (Bankr. S.D.N.Y. 1990) ("Residence, when used in a sense other than domicile, is one of the most nebulous terms in the legal dictionary and can have many different meanings depending on the context in which it is used."). Because the term "residence" is not defined under the Bankruptcy Code, courts have used two methods to interpret the term as used in § 522(d)(1): the majority "state law" approach, and the minority "plain meaning" approach. *In re Stoner*, 487 B.R. 410, 415-16 (Bankr. D.N.J. 2013).

Under the state law approach, courts have equated the term "residence" in § 522(d)(1), with the term "homestead," and looked to state law for the contours of the Debtor's right to exempt an interest in a homestead because "a homestead, as a property interest, is defined by state law." *Brown*, 299 B.R. at 428 (*citing Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 329 (1991)). As applicable here, Connecticut law provides for a homestead exemption, and defines a "homestead" as "owner-occupied real property . . .

used as a primary residence." Conn Gen. Stat § 52-352a. Courts have articulated a three factor test debtors must satisfy in order to be entitled to the Connecticut homestead exemption. "First, the individual must 'own' the subject real property within the meaning of [Conn. Gen. Stat.] § 52–352a as of the relevant time. Second, the individual must 'occup[y]' the subject real property within the meaning of [Conn. Gen. Stat. §] 52–352a as of the relevant time. Third, the subject real property must be 'used as a primary residence' within the meaning of [Conn. Gen. Stat.] 52–352a as of the relevant time." *In re Kujan*, 286 B.R. 216, 220-21 (Bankr. D. Conn. 2002).

But, Connecticut state law is not helpful to answer the question of whether an exemption may be asserted by a debtor when only the debtor's dependent (and not the debtor) uses the property as a residence. Connecticut's homestead exemption statute is similar to that of other states in the Second Circuit, in that, none of the exemption statutes in Connecticut, New York or Vermont addresses the right of a debtor to claim an exemption in property that a dependent of the debtor uses as a residence. *See,* N.Y.C.P.L.R. § 5206(a) (McKinney 2018); Vt. Stat. Ann. Tit. 27 § 101 (West 2018). Some states, including for example, Ohio, have exemption statutes that provide a debtor may claim an exemption in property that a dependent of the debtor uses as a residence. Ohio Rev. Code Ann. § 2329.66(a)(1)(b) (West 2017) (exempting a "person's interest, . . . in one parcel or item of real or personal property that the person or a dependent of the person uses as a residence."); *see also In re Miller*, 157 B.R. 621 (Bankr. N.D. Ohio 1993) (concluding a debtor was entitled to claim an exemption under Ohio law in property that his dependents resided in, but that he did not).

While federal courts look to state law to determine property rights, here, it appears the federal statute may afford coverage that is unaddressed in the applicable state statute, rendering state law inapplicable. *See generally, Butner v. United States*, 440 U.S. 48 (1979). The court's review of Connecticut law reveals nothing construing language similar to the Bankruptcy Code's exemption for property the dependent of a debtor uses as a residence.

The court concludes the minority approach, relying on the plain meaning of the federal statute, is better employed in this case. In reaching this conclusion the court begins with "the plain language of the statute," and "must presume that [Congress] says in a statute what it means and means in a statute what it says there," and apply the law as it is written. *Dodd v. United States*, 545 U.S. 353, 357 (2005); *Universal Church v. Geltzer*, 463 F.3d 218, 223 (2d. Cir. 2006). Under the "plain meaning" approach, some courts have examined the distinction between the word residence used in § 522(d)(1), and the word homestead, used more commonly under state law. Some courts have concluded that the use of the term "residence" in § 522, as opposed to the modified term "primary residence" as used in §§ 101(13A), 1123(b)(5) and 1322(b)(2), suggests Congress intended to permit a debtor to exempt a wider range of exempt property, compared to what a debtor would be entitled to exempt under state law. *In re Lawrence*, 469 B.R. 140, 142 (Bankr. D. Mass. 2012) ("The only other requirement for eligibility under § 522(d)(1) is that the debtor "uses" the residence."); *In re Demeter*, 476 B.R. 281, 291 (Bankr. E.D. Mich. 2012) (concluding that while Michigan law afforded an exemption to a homestead used as a "principle residence," a plaining reading of "residence" in § 522(d)(1), did not require that the debtors use the property as their "primary" residence.)

Here, the statute clearly provides that a debtor may claim an exemption in real property that "a dependent of the debtor uses as a residence."

As noted, the Debtor acknowledged that she did not use the Property as a residence or homestead for herself as of the Petition Date.[5] Rather, she claimed that the Property was used by her dependent Child as a residence, and thus she was entitled to claim an exemption in the Property pursuant to § 522(d)(1). Although the Creditor did not contest that the Child resided at the Property as of the Petition Date, she relied on Connecticut law to argue the Debtor is not entitled to claim an exemption in the Property because the Debtor herself does not use the Property as a residence at all and the Child does not use the Property as a primary residence. ECF No. 52.

Here, there does not appear to be a serious factual dispute regarding the Child's use of the Property. The Debtor asserted in her affidavit that the Property is "my dependent [child's] residence." ECF No. 57. The Creditor conceded that the Child spends time at the Property on "overnight and weekend visitation[]" with the ex-husband, but the Creditor asserted neither the Debtor, nor the Child, occupied the Property as an owner, nor used the Property as a primary residence. ECF No. 52. The parties agree the Child attends school in the school district where the Property is located, and the court finds that this fact, together with the acknowledgement that the Child regularly occupied the Property as of the Petition Date, establishes that the Child used the Property as a residence. That the Child uses the Property as a residence – and regardless of the

[5] In her petition and bankruptcy schedules, the Debtor listed her address as in a different town than the town where the Property is located. ECF No. 1. On Schedule A/B, the Debtor listed a "2/3 Interest" in the Property. ECF No. 1. On Schedule C, the Debtor claimed the Property as exempt under § 522(d)(1), valuing her exemption at $1.00, with the notation "Residence for dependent minor child . . . ." ECF No. 1. As discussed at Note 6, the court determines that the Debtor owns a 1/2 interest in the Property based on the record.

Debtor's use of the property – is sufficient for the Debtor to invoke the federal exemption scheme set forth in § 522(d)(1) of the Bankruptcy Code.

While some courts have applied the "primary residence" test to the § 522(d)(1) exemption, because state law homestead exemptions are typically available only for the "primary residence" of a debtor, Connecticut law is simply silent on the right of a debtor to claim as exempt an interest in property that a *dependent, but not a debtor*, uses as a residence. *See, Brown,* 299 B.R. at 428*.* That type of exemption (in a dependent's residence) is simply different from what Connecticut homestead exemption law contemplates, and is created entirely by the federal statute. According to Black's Law Dictionary a residence is "the place where one actually lives," and a person thus may have "more than one residence at a time." *In re Lawrence*, 469 B.R. 140, 142 (2012)(*citing* BLACK'S LAW DICTIONARY 1423 (9th ed. 2009)). Turning to the Bankruptcy Code itself, the court finds persuasive the argument that Congress could have said "primary" residence if that is what it meant, since it used that exact phrase in several other Bankruptcy Code provisions. *See,* 11 U.S.C. §§ 101(13A), 1123(b)(5) and 1322(b)(2).

Based on the circumstances presented here, the court concludes the Property need not be the primary residence of the dependent Child in order for the Debtor to claim an exemption in the Property. The constitutional authority of Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States" would clearly encompass a federal statute defining the right of a debtor to exempt property used by a dependent only when it is used as a primary residence. But Congress has not chosen to exercise its power to fashion any such rule. The court declines to add this requirement to the plain language of 11 U.S.C. § 522(d)(1).

The Value of the Property

Having determined the exemption applies under these facts, the question now becomes whether the Judicial Lien impairs the Debtor's exemption in the Property. The parties dispute the value of the Property as of the Petition Date. The best case scenario for the Creditor would be a determination that the value of the Property as of the Petition Date was $560,000.00. ECF No. 71. The mathematical formula to be applied under § 522(f), when a debtor claims an exemption in property she owns jointly, is to take the value of the lien to be avoided, plus the value of the debtor's interest of the consensual liens on the property, plus her claimed exemption. *In re Fox*, 353 B.R. 388, 393-94 (Bankr. D.Conn. 2006)(*citing Miller v. Sul (In re Miller)*, 299 F.3d. 183, (3rd Cir. 2002)). A judicial lien may be avoided to the extent the sum of those three figures exceeds a debtor's interest in the property. The formula articulated in *Miller* as applied here, must take into consideration the Debtor's interest in the Property, which the court assumes is one-half (1/2), based on the information set forth in the parties' appraisals.[6]

Here, both the Judicial Lien to be avoided and the claimed exemption apply to the Debtor's one-half interest in the Property, only. Taking the Creditor's value of $560,000.00 and dividing it in two results in a hypothetical value of $280,000.00 for the

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[6] While the Debtor's Schedule A/B indicated the Debtor owned a "2/3 Interest" in the Property with her ex-husband, the court assumes for purposes of this decision that the Debtor owns only a 1/2 interest in the Property with her ex-husband. The parties "Joint Stipulation of Facts," states that the "deed conveyed the Property to the couple jointly, with a right of survivorship." ECF No. 61, ¶ 3. Although the Joint Stipulation of Facts did not include a copy of the deed, both of the parties appraisal reports did include identical copies of the deed conveying the Property to the Debtor and the ex-husband. The language of the deed conveyed the Property to the Debtor and her ex-husband "as joint tenants with the rights of survivorship and not as tenants in common . . . " and makes no provision for granting the Debtor a 2/3 interest in the Property. *Compare*, ECF No. 1 with ECF No. 67, 71.

Debtor's one-half interest. The mortgage debt as of the Petition Date was $525,899.26, and half that amount is $262,949.63. Adding the applicable portion of the mortgage debt ($262,949.63) to the Judicial Lien figure ($70,943.00) and the claimed exemption amount ($23,675.00)[7], results in encumbrances against the Debtor's interest in the Property totaling $357,567.63. Subtracting the encumbrances totaling $357,567.63 from the hypothetical value of the Debtor's interest in the Property of $280,000.00 results in a negative: -$77,567.63.[8] It is clear that even if the court were to adopt the most generous value offered by the Creditor, or $560,000, there would be no equity above and beyond the Debtor's portion of the mortgage debt plus her statutory exemption available to secure the Creditor's Judicial Lien.[9]

Based on this analysis the court need not conduct an evidentiary hearing to determine the value of the Property because even if the Creditor were to win that fight, it would lose the war.

As to the interpretation of § 522(d)(1) as it relates to the exemption for property used by a dependent as a residence in this case, the court has considered all other arguments of the Creditor and finds them to be without merit.

<u>Conclusion</u>

For the foregoing reasons the Motion is granted and the Creditor's objection is overruled. The Judicial Lien of the Creditor is avoided pursuant to 11 U.S.C. § 522(d)(1),

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[7] Because the Debtor "would have been entitled" to an exemption in the amount of $23,675.00 pursuant to 11 U.S.C. § 522(d)(1), and because she elected to use the federal exemptions available under the Bankruptcy Code, the fact that the Debtor used a value of $1.00 on her Schedule C ("The Property You Claim as Exempt") is not relevant. *See*, 11 U.S.C. § 522(f).

[8] Assuming the Debtor did own a 2/3 interest in the Property, as she maintains in her Schedules, there would still be no equity above the Debtor's portion of the mortgage plus her statutory exemption to secure the Creditor's Judicial Lien.

[9] Independent of the Creditor's Judicial Lien, taking into account the Debtor's statutory exemption there is also no available equity to secure Citibank, N.A.'s judicial lien.

based on the use of the Property as a residence by the Debtor's minor, dependent Child on the Petition Date. A separate order granting the Motion using the Court's typical form of order that may be recorded on the land records will enter.

Dated on June 28, 2018, at New Haven, Connecticut.

Ann M. Nevins
United States Bankruptcy Judge
District of Connecticut

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT
HARTFORD DIVISION

IN RE:	:	CASE NO. 13-51186 (JJT)
JIE XIAO	:	
Debtor	:	CHAPTER 7
RONALD I. CHORCHES, TRUSTEE	:	
Movant	:	RE: ECF Nos. 458, 475
v.	:	
JIE XIAO	:	
Respondent	:	

POST TRIAL RULING ON CLAIMED PENSION EXEMPTION

I. INTRODUCTION

Before the Court is the Chapter 7 Trustee's Objection to the Debtor's Claim of Exemptions ("Objection", ECF No. 475). Therein, the Chapter 7 Trustee, Ronald Chorches ("Trustee") objects to the claimed exemption of funds by the Debtor, Jie "George" Xiao ("Mr. Xiao" or "Debtor") in the LXEng, LLC ("LXEng") Pension Plan ("Plan") valued in the amount of $414,533.40. While initially claimed as an exemption under 11 U.S.C. § 522(d)(10),[1] the Court tried this case based upon the Debtor's belated amendment of the exemption (ECF No. 458) pursuant to 11 U.S.C. § 522(d)(12). The gravamen of this matter concerns the Bankruptcy Code's exemption for certain tax-exempt retirement funds. For the reasons stated herein, the Objection is SUSTAINED.

II. PROCEDURAL HISTORY

On July 30, 2013 ("Petition Date"), the Debtor commenced this proceeding by filing a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. The Debtor claimed an ownership interest in all of the assets of the Plan on his Amended Schedule B (ECF No. 27),

[1] Unless otherwise noted, all future statutory references are to Title 11 of the United States Code, sometimes referred to as the "Bankruptcy Code" or "Section ___".

having a value of $412,533.40 as of the Petition Date, and disclosed a 100% interest in LXEng on his Amended Schedule B, having a value of $0.00. The Debtor claimed an exemption in all of the assets of the Plan pursuant to 11 U.S.C. § 522(d)(l0)(E). The Debtor's Schedules reveal that he also claimed exemptions in other assets, including four different pension plans, which have gone unchallenged. The Debtor's Schedules further reveal nearly $1 million in general unsecured debt, plus disputed and unliquidated litigation claims by Dow Corning Corp. and its affiliate.

On November 20, 2014, the Trustee filed the Objection to the Plan exemption (ECF No. 271). After no response from the Debtor for almost two years, on July 29, 2016, the Trustee filed a Motion for Summary Judgment on the Objection (ECF No. 393). On September 29, 2016, the Debtor filed a Response, an Opposition Brief, an Affidavit in Opposition, a Local Rule 56(a)(2) Statement, and a Response to the Trustee's Objection to the Debtor's exemption (ECF Nos. 397, 398, 399, 400, 401). The Court issued a scheduling order setting deadlines for discovery to be completed within sixty days and directing the Debtor to file monthly reports on the Plan (ECF No. 410).

On November 15, 2016, the Trustee filed a Motion for a Stand-Still Order Regarding the Plan Assets (ECF No. 413), to which the Debtor objected (ECF No. 415). The Court issued a Memorandum of Decision granting the Trustee's Motion for Stand-Still Order on December 1, 2016 (ECF No. 423). On December 13, 2016, the Debtor requested an extension of time to complete discovery and submit an expert report (ECF No. 427). The Court granted his request, and set further deadlines for discovery (ECF No. 440).

On January 27, 2017, the Debtor filed a Supplemental Document in Opposition to the Trustee's Motion for Summary Judgment (ECF No. 445), accompanied by an amended Local Rule 52(a)(2) Statement (ECF No. 447) and a Memorandum of Law in Opposition to the

Trustee's Motion for Summary Judgment written by the Debtor's expert (ECF No. 446). On March 20, 2017, the Debtor amended his Schedule C to change the Plan's exemption from a claim under 11 U.S.C. § 522(d)(10) to one under 11 U.S.C. § 522(d)(12) (ECF No. 458), to which the Trustee later objected (ECF No. 475). The Trustee also filed a Reply to the Debtor's Opposition to Summary Judgment (ECF No. 459) on March 20, 2017.

On May 25, 2017, the Court denied the Trustee's Summary Judgment Motion (ECF No. 510), finding a genuine dispute of material fact as to whether the Debtor was materially responsible for the Plan's noncompliance, and reserving judgment on whether there were additional facts in genuine dispute. The parties subsequently submitted a joint pre-trial order (ECF No. 516) on June 27, 2017 to advance the case to trial based upon the amended exception claim.

On September 12 and 13, 2017, the Court held a two-day trial on the Objection. During the course of the trial, the Court heard testimony from the Trustee, his expert, John V. Galiette, Esq. ("Mr. Galiette"), Michael F. Ostuni ("Mr. Ostuni"), and Mr. Xiao. In rebuttal, the Debtor advanced his own testimony and that of his expert Andrew J. Fair, Esq. ("Mr. Fair"), and Mr. Ostuni.

Although the contest was vigorous, few of the facts advanced by the Trustee at trial were successfully rebutted. Notably, Mr. Xiao's testimony was generally repetitive, self-serving, and unconvincing. Thematically, he professed ignorance of the nature and consequence of the professional advice he garnered to assist his company LXEng in the formation and administration of the Plan, and professed his abdication of material decisions to advisors. His protestations of reliance upon the advisors notwithstanding, his credibility was strained, and his testimony was conclusory, evasive and seemingly rehearsed. His recollection of certain events also appeared to this Court to be selective in favor of those that served his interests. The effect and calculus achieved by the decisions and modifications made to the Plan were, according to Mr. Xiao's advisors, at his behest and at all times manifestly served to exclusively benefit Mr. Xiao and his then wife, Xin Chen ("Ms. Chen"). In the end, his tortured, incomplete, and contrived navigation of the Internal Revenue Code ("IRC")[2] compliance requirements for the Plan in order to support his claimed exemption under 11 U.S.C. § 522(d)(12) fails for the reasons articulated herein.

III. JURISDICTION

The Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b) and derives its authority to hear and determine this matter on reference from the District Court pursuant to 28 U.S.C. §§ 157(a) and (b)(1). This is a core proceeding under 28 U.S.C. § 157(b)(2)(B).

IV. FINDINGS OF FACT[3]

In accordance with Fed. R. Civ. P. 52 and Fed. R. Bankr. P. 7052, after consideration of the trial testimony and argument, the documents admitted into evidence, and examination of the record of the trial, the Court finds the following facts.

Formation of LXEng and the Plan

1. Mr. Xiao and Ms. Chen were married in 1992, and they have two children together. Jt. Stip. Facts, ¶1.

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[2] *See* 26 U.S.C. §§ 1–9602. For purposes of this opinion, future references to title 26 of the United States Code will be cited as "I.R.C. Section ___".

[3] The Court's finding of the underlying facts is drawn from the following: the debtor's admissions in pleadings, including the Joint Stipulation of Undisputed Facts and Exhibits (ECF Nos. 524, 533, 539) and the Debtor's Post Trial Brief (ECF No. 543); trial exhibits; the docket of the bankruptcy case; and the record of the two day trial held on September 12, 2017 (ECF No. 530) and September 13, 2017 (ECF No. 532). References to the audio record of the trial will appear in the following format, respectively: Tr. 1, __, Tr. 2 at __. The parties submitted proposed Findings of Fact and Conclusions of Law following the trial.

2. Mr. Xiao has a bachelor's degree from Shanghai Jiao Tong University and received a Ph.D. in chemistry from the University of Michigan in 1996. Jt. Stip. Facts, at ¶2.
3. Mr. Xiao and Michael Little ("Mr. Little") formed LXEng in 2007. Jt. Stip. Facts, at ¶3. LXEng was an engineering consulting company which sold technology packages and services to its clients. Tr. 1, 2:45; Tr. 2, 0:11–12.
4. Mr. Xiao and Mr. Little were each initially 50% owners of LXEng. Jt. Stip. Facts, ¶4. Mr. Little died in an airplane crash on November 3, 2007. Jt. Stip. Facts, ¶5.
5. After Mr. Little's death, Ms. Chen was made a 10% owner of LXEng and Mr. Xiao took a 90% ownership of LXEng. Jt. Stip. Facts, ¶6. Mr. Xiao became the managing member of LXEng. Jt. Stip. Facts, ¶7.
6. On December 15, 2007, the Plan was formed with an effective date retroactive to January 1, 2007. Jt. Stip. Facts, ¶8.
7. At the time of the Plan's adoption, Mr. Xiao owned 90% of LXEng and Ms. Chen owned 10% of LXEng. Tr. 1, 1:51.
8. The Plan was based on the MassMutual Life Insurance Company Prototype Standard Non-Integrated Defined Benefit Pension Plan. Jt. Stip. Facts, ¶9.
9. The co-trustees of the Plan were Mr. Xiao and Ms. Chen. Jt. Stip. Facts, ¶¶ 10, 13.
10. Mr. Xiao signed the Plan on behalf of LXEng, the Employer and Administrator of the Plan. Jt. Stip. Facts, ¶12.
11. The Plan listed Keystone Healthcare, LLC ("Keystone"), as a "Participating Employer" under the Plan. Jt. Stip. Facts, ¶11. Keystone was a consulting company that Mr. Xiao had previously established to provide certain consulting services in the pharmaceutical industry. Tr. 1, 2:45; Tr. 2, 0:11–12.

12. Mr. Xiao was the 100% owner of Keystone by, at the latest, July 30, 2013. Tr. 2, 0:04–07. Keystone was operated from Mr. Xiao's home. Tr. 2, 0:08–09.

13. No business relationship existed between Keystone and LXEng other than that the Debtor owned both companies. Tr. 1, 2:45; Tr. 2, 0:11–12.

14. Mr. Xiao signed the Plan on behalf of Keystone as the Participating Employer. Jt. Stip. Facts, ¶14.

15. Ms. Chen was never employed by Keystone. Tr. 1, 2:48.

16. The Plan, as originally adopted in 2007, did not permit the use of life insurance policies to fund a death benefit. Tr. 1, 4:12; Ex. T1, at ¶33.

17. As of December 31, 2007, both Mr. Xiao and Ms. Chen were listed as "highly compensated employees" of LXEng. Jt. Stip. Facts, ¶16.

18. For the calendar year 2007, LXEng reported to the Internal Revenue Service ("IRS") ordinary business income of $1,341. Ex. T11.

19. As of December 31, 2008, Mr. Xiao and Ms. Chen were still listed as the only two participants in the Plan, and were each 20% vested under the six-year vesting schedule. Jt. Stip. Facts, ¶¶ 17, 18. They remained listed as "highly compensated employees" of LXEng. Jt. Stip. Facts, ¶19.

20. For the calendar year 2008, LXEng reported ordinary business income of $462,747 to the IRS. Ex. T12.

21. The IRS issued an opinion letter dated April 29, 2002, which related to the prototype plan adopted by LXEng. Tr. 2, 2:39–40; Ex. T1.

22. The IRS issued an opinion letter dated March 31, 2010, which related to the form of the Plan under the IRC. Tr. 1, 3:02; Ex. T3.

LXEng's Professionals

23. PenServ, Inc. ("PenServ") acted as the third-party administrator of the Plan. Jt. Stip. Facts, ¶38.

24. A third-party administrator is a service provider that performs specific functions. A third-party administrator has no discretionary authority, unless it has specifically agreed to undertake fiduciary responsibility. Tr. 1, 1:52; 3:19–20.

25. Mr. Ostuni was the president and 100% owner of PenServ. Tr. 1, 0:34.

26. PenServ was not a fiduciary of the Plan and was unable to take any actions regarding the Plan without direction from LXEng, Mr. Xiao as the owner of LXEng, or LXEng's advisors Lloyd Cazes ("Mr. Cazes") and Michael Caputo ("Mr. Caputo"). Tr. 1, 0:38–39.

27. Mr. Cazes and Mr. Xiao had known each other for a long time. Tr. 2, 0:27. Mr. Cazes was the accountant for Mr. Xiao, LXEng, Keystone, and the vast majority of Mr. Xiao's other United States entities. Tr. 2, 0:27–28.

28. Mr. Cazes filed LXEng's 2007, 2008, 2009, and 2010 tax returns with the IRS at Mr. Xiao's direction. Tr. 2, 0:29–32; Exs. T11-14. Mr. Cazes held all of Mr. Xiao's, Keystone's, and LXEng's financial records for the years 2005–2013. Tr. 2, 0:32–33.

29. Mr. Caputo was retained by LXEng as a financial planner. Tr. 2, 1:17.

30. Mr. Cazes and Mr. Caputo were, at all relevant times, agents of LXEng. Tr. 2, 3:24.

The First Discretionary Amendment

31. Initially, the Plan required one year of service, meaning that the employee has completed at least 1,000 hours of service to LXEng, and attainment of age 21 to be eligible to participate in the Plan. Tr. 1, 0:48–49; Ex. T1, at ¶¶ 15, 18. The beginning date for any prospective participant in the Plan was the earlier of the first day of July or the first day of January

coinciding with or following the date on which the participant has met the requirements to participate in the Plan. Ex. T1, at ¶16.

32. Plan participants would have their benefits vest over a six-year graded period, with 20% vesting after two years and each additional year resulting in an additional 20%. A year of service for vesting meant a twelve-month period beginning on an employee's date of employment or any anniversary of that date during which he or she completed at least 1,000 hours of service. Tr. 1, 0:48–50; Ex. T1, at ¶¶ 18, 34

33. As of December 31, 2007, there were only two participants in the Plan, Mr. Xiao and Ms. Chen. Their dates of hire were listed as July 1, 2005. Jt. Stip. Facts, ¶15. Neither Mr. Xiao's nor Ms. Chen's benefits in the Plan had vested because they had not reached the two-year service requirement under the six-year graded vesting schedule. Ex. T7, at p. 5 (Employee Census).

34. The Plan was amended on March 1, 2009, effective retroactively to January 1, 2009 (the "2009 Amendment"). Jt. Stip. Facts, ¶20; Ex. T4. PenServ prepared the 2009 Amendment at the direction of LXEng. Tr. 1, 0:55. It was a discretionary amendment elected by LXEng. Tr. 1, 51.

35. Mr. Xiao signed the 2009 Amendment on behalf of LXEng, as the Employer and Administrator of the Plan, and with Ms. Chen, as co-trustee. Jt. Stip. Facts, ¶21.

36. As of January 1, 2009, when the 2009 Amendment went into effect, LXEng had eleven employees in addition to Mr. Xiao and Ms. Chen. Tr. 1, 2:10; Ex. T9, at p. 5 (Employee Census). At the time, the Plan's only participants were Mr. Xiao and Ms. Chen. Tr. 1, 0:53.

37. The 2009 Amendment excluded from Plan participation non-owner employees who were highly compensated employees. Tr. 1, 0:51–52, 2:19–21; Ex. T4. The 2009 Amendment also

increased the years of service to become eligible for participation from zero to two years and provided for 100% vesting immediately for all current Plan participants. Tr. 1, 0:51–52, 0:54, 2:19–21; Ex. T4.

38. The effect of the 2009 Amendment was to extend the participation requirement of the remaining employees of LXEng to two years. Tr. 1, 0:53–55.

39. Mr. Xiao and Ms. Chen became fully vested in the Plan as a result of the 2009 Amendment. Ex. T9, at p. 5 (Employee Census).

40. PenServ would never have advised LXEng, or any other client, to adopt an amendment similar to the 2009 Amendment. Tr. 1, 0:55.

The Second Discretionary Amendment

41. During 2010, LXEng had between ten and fifteen employees, including Mr. Xiao and Ms. Chen. Tr. 2, 0:44–45.

42. On December 15, 2009, the Plan was amended effective as of January 1, 2010 ("2010 Amendment"). Jt. Stip. Facts, ¶24. The 2010 Amendment was also a discretionary amendment. Tr. 1, 0:51, 56.

43. The 2010 Amendment froze participation in the Plan against employees who were not already participants of the Plan as of January 1, 2010, as well as benefits accrual. Tr. 1, 0:56–57, 2:22–23; Ex. T5.

44. The practical effect of the 2010 Amendment was to exclude all then-present LXEng employees and any future LXEng employees from participating in the Plan and to prevent their accrual of benefits under the Plan, with the exceptions of Mr. Xiao and Ms. Chen. Tr. 1, 2:24–25.

45. The 2010 Amendment was offered to LXEng as an option by PenServ based upon information PenServ received from LXEng, Mr. Xiao, Mr. Cazes, and Mr. Caputo that adverse business conditions had arisen and allegations that the Plan had become too costly. Tr. 1, 0:57–1:01.

46. PenServ relied upon its clients to inform it of their business conditions. Tr. 1, 1:01.

47. LXEng's business was expanding and its taxable income was growing substantially from $462,747 in 2008 to $989,384 in 2009 to $1,601,481 in 2010. Tr. 1, 4:12–18; Ex's. T12-14.

48. In 2010, LXEng recognized revenue in excess of $4 million and had received a payment of $6 million from one of its contracts. At the same time, LXEng still had a $3 million receivable, and it had access to a $2.9 million legal reserve fund. Tr. 2, 0:51–54.

49. PenServ offered options to LXEng relating to the alleged adverse business conditions other than freezing the Plan benefits and participation, but left the final decision of whether to freeze the Plan to LXEng's discretion. Tr. 1, 1:02.

50. Mr. Xiao signed the 2010 Amendment on behalf of LXEng, as the Employer and Administrator of the Plan, and, with Ms. Chen, as co-trustee. Jt. Stip. Facts, ¶25.

51. As of January 1, 2010, Mr. Xiao and Ms. Chen were still listed as the only two participants in the Plan. Jt. Stip. Facts, ¶26.

52. Several of LXEng's employees, including Joe Garcia, Kevin Corkwell, Robert Brown, and Thomas Barker, would have been participants in the Plan by 2010 or 2011 if not for the 2009 and 2010 Amendments. Tr. 1, 2:31–33; Ex. T9, at p. 5 (Employee Census).

53. The timing of the 2009 Amendment and 2010 Amendment was designed to prevent anyone other than Mr. Xiao or Ms. Chen from becoming participants in the Plan or deriving any benefits from the Plan. Tr. 1, 2:42–43.

The Mandatory Amendments

54. PenServ advised LXEng and Mr. Xiao on January 26, 2009 that it was necessary to amend the Plan pursuant to IRC requirements. Tr. 1, 0:40–41; Ex. T17.

55. PenServ prepared the necessary amendments for LXEng and provided the instructions for executing the said amendments. Tr. 1, 0:41–42; Ex. T17. PenServ was not aware whether LXEng ever executed the January 26, 2009 amendments because an executed copy was never provided to PenServ by LXEng. Tr. 1, 0:43.

56. PenServ advised LXEng and Mr. Xiao on December 4, 2009 that it was necessary to amend the Plan pursuant to Pension Protection Act of 2006 and the Heroes Earnings Assistance and Relief Tax Act of 2008. Tr. 1, 0:43–44; Ex. T18.

57. PenServ prepared the necessary amendments for LXEng and provided the instructions for executing the said amendments. Tr. 1, 0:44; Ex. T18. PenServ was not aware whether LXEng ever executed the December 4, 2009 amendments because an executed copy was never provided to PenServ by LXEng. Tr. 1, 0:44–45.

58. Mr. Ostuni spoke with Mr. Xiao by telephone about the necessary amendments and requested executed copies of the amendments. Tr. 1, 0:45.

59. As of December 31, 2009, Mr. Xiao and Ms. Chen were still listed as the only two participants in the Plan, and were listed as "highly compensated employees." Jt. Stip. Facts, ¶¶ 22, 23.

60. For the calendar year 2009, LXEng reported ordinary business income of $989,384 to the IRS. Ex. T13.

61. On October 29, 2010, PenServ sent a letter to LXEng and Mr. Xiao informing them that the Plan needed to be amended and restated pursuant to the Economic Growth and Tax Relief

Reconciliation Act ("EGTRRA"). Tr. 1, 46-47; Ex. T19. The Plan was amended and restated as of December 15, 2011 to comply with EGTRRA. Tr. 1, 2:59-3:00; Ex. T2.

62. The EGTRRA restatement of the Plan did not have any effect on the applicability of the 2009 Amendment, the 2010 Amendment, or the termination of the Plan. Tr. 1, 3:00.

LXEng Fully Funds the Plan

63. In September 2010, after the 2010 Amendment, LXEng deposited $38,849 into the Plan to fully fund the Plan for the calendar year 2009, the last year before the Plan was frozen. Tr. 1, 1:04-07; Ex. T20. At the time, the minimum funding requirement was $23,058. Tr. 1, 1:07.

64. LXEng had already met its minimum funding requirement for the calendar year 2009 and, thus, there was no obligation to deposit the additional $38,849 into the Plan. Tr. 1, 1:36; Ex. T20.

65. Mr. Xiao authorized the $38,849 payment in a conversation with Mr. Cazes. Tr. 2, 0:39–40; Ex. T20.

Termination of the Plan

66. LXEng terminated the Plan effective January 15, 2011, by a resolution dated January 1, 2011. Jt. Stip. Facts, ¶27.

67. Mr. Xiao signed the resolution as the "Principal" of LXEng and solely acknowledged receipt of the resolution on behalf of the Plan as co-trustee. Jt. Stip. Facts, ¶28.

68. Mr. Xiao and Ms. Chen were the only participants in the Plan at the time it was terminated. Tr. 1, 2:25.

69. The Plan was only in operation for approximately four years. Tr. 1, 2:25–26.

70. After the Plan was terminated, PenServ advised Mr. Caputo of the requirements for winding down the Plan and distributing the assets. To date, these actions have not been taken. Tr. 1, 1:10.

Divorce and Transfer of Ms. Chen's Interest in the Plan

71. On June 12, 2013, Ms. Chen filed a Complaint for Divorce in the Superior Court of New Jersey, Chancery Division, Family Part of Morris County ("Divorce Action"). Jt. Stip. Facts, ¶29.

72. On July 3, 2013, a Judgment of Divorce was entered between Mr. Xiao and Ms. Chen in the Divorce Action. Jt. Stip. Facts, ¶30.

73. As a result of the Judgment of Divorce, Ms. Chen relinquished her 10% ownership of LXEng to Mr. Xiao, as well as her interest in the Plan. Jt. Stip. Facts, ¶31.

Bankruptcy Filing and Claim of Exemption

74. On July 30, 2013, the Petition Date, Mr. Xiao filed for voluntary bankruptcy relief under Chapter 7 of the Bankruptcy Code. Jt. Stip. Facts, ¶33. As of the Petition Date, Mr. Xiao was the sole participant and the sole beneficiary of the Plan. Tr. 1, 2:06, 2:51, 3:23.

75. As of December 31, 2013, the Plan had $471,951.00 in a brokerage account at Summit Equities, Inc. Jt. Stip. Facts, ¶32.

76. On August 7, 2013, Mr. Xiao filed Schedules A-J to supplement his bankruptcy petition. In Schedule C, he claimed an exemption to the entirety of the Plan's assets pursuant to 11 U.S.C. § 522(d)(10)(E) (ECF No. 12). On November 20, 2014, the Trustee filed an objection to Mr. Xiao's claim of exemption (ECF No. 270).

77. On March 20, 2017, Mr. Xiao amended his claim of exemption in the Plan to one under 11 U.S.C. § 522(d)(12) (ECF No. 458). On March 29, 2017, the Trustee filed an objection to Mr. Xiao's amended claim of exemption (ECF No. 475).

78. On November 15, 2016, the Trustee filed a Motion for a Stand-Still Order Regarding the Plan Assets (ECF No. 413), to which the Debtor objected (ECF No. 415). The Court issued a Memorandum of Decision granting the Trustee's Motion for Stand-Still Order on December 1, 2016 (ECF No. 423). That decision directed that the Debtor neither interfere with nor dissipate the Plan's assets during the pendency of this case.

V. CONCLUSIONS OF LAW

A. Applicable Law

Pursuant to Section 522(d)(12), a debtor may exempt "[r]etirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the IRC."[4] 11 U.S.C. § 522(d)(12).[5] There are alternative tests for making this determination. First, if a plan has received a favorable determination under I.R.C. Section 7805 and the determination is in effect as of the petition date, a plan will be presumed to be exempt. 11 U.S.C. § 522(b)(4)(A). If there has been no favorable determination, the debtor must demonstrate either: (1) that no prior determination to the contrary has been made by a court or the IRS; and (2) that the plan is in substantial compliance with the applicable requirements of the I.R.C., or that the debtor is not materially responsible for any failure to be in substantial compliance. 11 U.S.C. § 522(b)(4)(B).

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[4] These sections of the Internal Revenue Code deal with pension, profit sharing, and stock bonus plans; employee annuities; individual retirement accounts; deferred compensation plans of state, local government, and tax-exempt organizations; and certain trusts. Alan N. Resnick & Henry J. Sommer, 4 Collier on Bankruptcy ¶522.09[12] (16th ed. 2015).

[5] Section 522(b)(3)(C) includes identical language allowing debtors in states that have opted out of the federal exemptions scheme to also claim as exempt "retirement funds." 11 U.S.C. § 522(b)(3)(C).

B. There is no Presumption of Exemption Under Section 522(b)(4)(A)

Section 522(b)(4)(A) provides that if the retirement fund has received a favorable determination, and that determination is in effect as of the petition date, those funds shall be presumed to be exempt from the bankruptcy estate. The Debtor here claims that the IRS letters issued in 2002 and 2010 are favorable determinations that entitle the Plan to a presumption of exemption. Exs. T1, T3. However, the determination letters merely found the *form* of the plan acceptable. *Id.* "[This] opinion relates only to the acceptability of the form of the plan under the Internal Revenue Code." *Id*. The letters specifically state that they are "not a ruling or determination as to whether an employer's plan qualifies under Code Section 401(a)[,]" and that the terms of the Plan "must be followed in operation."[6] *Id*. For this reason, a number of courts have not given presumptive effect to such letters under Section 522(b)(4)(A). *See RES-GA Dawson, LLC v. Rogers (In re Rogers)*, 538 B.R. 158, 173 (Bankr. N.D. Ga. 2015) ("[A] favorable opinion letter as to the form of a prototype plan by itself is not a sufficient 'favorable determination' for purposes of § 522(b)(4)(A)."); *In re Bauman*, 2014 WL 816407, at *14 (Bankr. N.D. Ill. 2014) ("A letter of this kind, addressing only 'form' and not 'operation' does not raise the presumption under section 522(b)(4)(A).") (citing *Agin v. Daniels (In re Daniels)*, 452 B.R. 335, 347 (Bankr. D. Mass. 2011), *aff'd on other grounds*, 482 B.R. 1 (D. Mass. 2012), *aff'd sub nom Daniels v. Agin*, 736 F.3d 70 (1st Cir. 2013).

Furthermore, the Plan was submitted for form approval to the IRS on January 31, 2008, after the time that both discretionary amendments were made. Mr. Fair conceded that once

[6] The letters also state that an employer that adopts the form plan may rely on the letter with respect to the qualification of its particular plan in certain circumstances and cites Rev. Proc. 2005-16, which includes provisions delineating the circumstances in which an employer can rely on an opinion letter governing a volume submitter form plan as applying also to the employer's specific plan. *See* Rev. Proc. 2005-16, § 19.02. The letter further states that the opinion applies with respect to IRC Section 401(a)(26) if 100% of all nonexcludable employees benefit under the plan. In these cases, the opinion letter is the equivalent of a favorable determination letter. *Id*. at § 19.04. However, these provisions do not apply to this case, and the Court heard no evidence asserting otherwise.

changes are made to a plan, such as the discretionary amendments LXEng made here, the plan is no longer protected by such determination letters. Tr. 2, 2:41. Accordingly, there is no presumption that the Plan is exempt under Section 522(b)(4)(A), and Debtor's contentions to the contrary are misleading and without merit.

C. The Plan is Not in Substantial Compliance with the IRC

Under Section 522(b)(4)(B), if there is no effective determination concerning the plan, the debtor must show, as one alternative, that no contrary ruling was made by the IRS or a court, and that the plan was in substantial compliance with the requirements of the IRC.

Here, there was no prior determination to the contrary made by a court or the IRS. The evidence presented at trial, however, overwhelmingly supports that the Plan was not in substantial compliance with the IRC. The evidence showed that the Plan fatally deviated from a number of IRC requirements: (1) that it be a permanent plan; (2) the minimum participation requirements under IRC Section 401(a)(26) and related regulations; (3) the exclusive benefit requirements and nondiscrimination requirements under IRC §§ 401 (a)(2) and (a)(4), respectively; and (4) the requirement that the Plan be operated in accordance with its terms. Tr. 1, 2:27–49, 3:26–28; Tr. 2, 2:07; Exs. T1, T9, T32, T33. The cumulative effect of these deviations convinces this Court that the Plan was not in substantial compliance with the IRC.

i. The Plan Violated the Permanency Requirement

As a condition for its qualification, a plan must be established with the goal of being a permanent, rather than a temporary, program. Therefore, although an employer may reserve the right to amend or terminate a plan, the abandonment of a plan for any reason other than business necessity within a few years after it has taken effect will be evidence that the plan, from its inception, was not a bona fide program for the exclusive benefit of employees in general. *See* 26

C.F.R. § 1.401-l(b)(2). As Mr. Galiette testified, the violation of the permanency requirement is determined by a facts and circumstances test, and valid business reasons justifying the termination of a plan within ten years include adverse business conditions, the liquidation of an employer, or the dissolution of an employer. Tr. 2, 2:45–2:46.

In weighing the totality of the facts and circumstances in this case, as well as Mr. Xiao's lack of credibility, the weight of the evidence shows that the Plan was not established with the goal of being a permanent plan for the benefit of employees. Mr. Galiette credibly testified that based on his expert opinion, the Plan was terminated only shortly after it was initiated, at a time when only the owners of LXEng were participants and beneficiaries, while the Plan was fully funded, and when the Plan sponsor faced no adverse business conditions. Tr. 1, 2:01–03; Tr. 1, 2:26–27.

Mr. Fair, the Debtor's expert, unconvincingly testified that the Plan was terminated because LXEng faced prospective adverse business conditions. In delivering his expert opinion, however, it became clear that Mr. Fair relied exclusively on the deposition testimony of Mr. Xiao and Mr. Ostuni in opining that a valid business reason existed to terminate the Plan. Tr. 2, 2:46–47. He neither reviewed LXEng's tax returns for the years 2007–2010, nor was he aware that in 2010, LXEng recognized revenue in excess of $4 million, and had received a payment of $6 million from one of its contracts. Tr. 2, 2:48–50. He was also unaware of the fact that in the same year, LXEng still had a $3 million receivable and access to a $2.9 million legal reserve fund. Tr. 2, 2:50–51. Accordingly, the Court gives little weight to the uninformed opinion of Mr. Fair in his assessment of this issue. This Court also finds that, given the Debtor's income at the time the Plan was terminated, it was not facing adverse business conditions. The Debtor provided no other explanation for why the Plan could justifiably be terminated. As Mr. Galiette testified, violation of the permanency requirement would, by itself, be enough to disqualify the Plan under the IRC. Tr. 1, 2:26. Accordingly, this Court finds that, based on the totality of the facts and circumstances in this case, the Plan violated the permanency requirement of the IRC.

ii. The Plan Violated the Minimum Participation Requirements

IRC Section 401(a)(26) provides that in order for a trust to constitute a qualified trust, the trust must be part of a plan which, on each day of the plan year, benefits the lesser of (1) fifty employees of the employer; or (2) the greater of 40% of the employees of the employer or two employees (or if there is only one employee, such employee). *See also* 26 C.F.R. § 1.401(a)(26)-2(a).

Here, this Court finds that the Plan also violated the minimum participation requirement. As is evidenced by the Employee Census, the Plan did not benefit at least fifty employees, or the greater of 40% or two employees of LXEng, at any point during its existence. Ex. T9. Mr. Galiette testified that as of January 1, 2010, six employees would have satisfied the Plan eligibility requirements, meaning that there should have been at least three employees benefiting under the Plan. Tr. 1, 2:27–32. The only two employees benefiting under the Plan, however, were Mr. Xiao and Ms. Chen. Similarly, in 2011, ten employees would have been eligible to participate, meaning that at least four were required to benefit under the Plan. The only employees who benefited under the Plan in 2011 were Mr. Xiao and Ms. Chen. This testimony was not rebutted.

Furthermore, the trial testimony established that none of the exceptions to the minimum participation rule apply in this case because: (1) the Plan benefited highly compensated employees; (2) the Plan was not a collectively bargained multiemployer plan; (3) the Plan was not a frozen underfunded plan subject to the requirements of the Employee Retirement Income

Security Act of 1974 (hereinafter "ERISA"); (4) the Plan was "top-heavy";[7] (5) the Plan was not a 401(k) plan maintained by a governmental or tax-exempt entity; (6) and the Plan was not acquired by a second company through a merger or acquisition. Tr. 1, 2:33–36. Therefore, this Court finds that the Plan violated the minimum participation rule which, alone—according to both parties' experts—would be enough to disqualify the Plan. Tr. 1, 2:38; Tr. 2, 2:07.

iii. The Plan Violated the Nondiscrimination and Exclusive Benefit Requirement

IRC Section 401(a)(4) prohibits a plan from discriminating in favor of a subset of highly compensated employees by providing that a plan will be qualified only "if the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees." 26 C.F.R. § 1.401(a)(4). The Department of Treasury Regulation provides:

> If the plan is so designed as to amount to a subterfuge for the distribution of profits to shareholders, it will not qualify as a plan for the exclusive benefit of employees . . . . [A] plan is not for the exclusive benefit of employees in general if, by any device whatever, it discriminates either in eligibility requirements, contributions or benefits in favor of employees who are officers, shareholders . . . or the highly compensated employees.

26 C.F.R. § 1.401-1(b)(3). Therefore, in order to satisfy the requirements of IRC Section 401(a)(4), the timing of plan amendments may not have the effect of discriminating significantly in favor of highly compensated employees. *See* 26 C.F.R. § l.40l(a)(4)-l(b)(4). For this purpose, a plan amendment includes the establishment or termination of a plan and any change in the benefits, rights, features, or benefit formulas of the plan. Whether the timing of a plan amendment or series of plan amendments has the effect of discriminating significantly in favor of highly compensated employees is based on all of the relevant facts and circumstances. *See* 26 C.F.R. §§ l.401(a)(4)-5(a)(1), (2). In determining whether a plan complies with the requirements

[7] According to Mr. Galiette's testimony, "top-heavy" means that the only beneficiaries of the Plan are "key employees," and both Mr. Xiao and Ms. Chen were key employees of LXEng. Tr. 1, at 2:34.

of IRC Section 401(a), the law looks not only to the form of the plan, but also to its operation. 26 C.F.R. § 1.401-l(b)(3); *see also Plunk v. Yaquinto (In re Plunk),* 481 F.3d 302, 307 (5th Cir. 2007).

Here, the evidence shows that the Plan violated the anti-discrimination requirement of IRC Section 401(a)(4) and the exclusive benefit rule of IRC Section 401(a)(2). Mr. Galiette credibly testified that the adoption of the 2009 Amendment and 2010 Amendment and the timing of the termination of the Plan collectively excluded from participation or the accrual of benefits any employees of LXEng other than Mr. Xiao and Ms. Chen, who were highly compensated employees. First, Mr. Xiao increased the eligibility period in 2009 to exclude employees whom he had hired in or after 2008 and accelerated his and Ms. Chen's vesting of the accrued benefits to 100%. Next, Mr. Xiao froze the Plan to new participants, effective as of January 1, 2010, on the eve of when several of LXEng's employees would have become eligible to participate in the Plan under the two-year eligibility period.

Additionally, the timing of the $38,849.00 payment into the Plan supports the inference that the Plan was only ever intended to benefit Mr. Xiao and Ms. Chen. Mr. Xiao had no obligation to deposit this amount into the Plan since the minimum funding had already been met for the calendar year 2009. The effect was to segregate funds for the sole benefit of Mr. Xiao and Ms. Chen, while freezing out all other employees. Tr. 1, 3:26–28. As Mr. Galiette testified, violation of either the anti-discrimination requirement or exclusive benefit rules would, alone, be enough to disqualify the Plan under the IRC. Tr. 1, 2:43. Accordingly, this Court finds that the Plan violated the anti-discrimination and exclusive benefit requirements.

iv. The Plan Was Not Operated in Accordance With its Terms

In order to be qualified, a plan must be operated in accordance with a definite written program. *See* 26 C.F.R. § 1.401-l(a)(2). The failure to operate a plan in accordance with its terms constitutes an operational defect that adversely affects the qualification of the plan. *See* Rev. Proc. 2013-12, § 5.01(2)(b) (definition of Operational Failure).

Mr. Galiette testified that the Plan was not operating in accordance with its terms because it purchased life insurance policies. Tr. 1, 2:43–45; T1, at ¶¶ 17, 33. Mr. Fair, however, sufficiently rebutted that testimony by his opinion that the mere purchase of a life insurance policy, which is akin to making an investment, is not a disqualifying act.

Mr. Galiette also testified, however, that according to the Plan, no prior service with another company was to be recognized in the calculation of benefits. Despite that provision, the Plan credited Mr. Xiao and Ms. Chen's alleged service with Keystone in order to qualify them for benefits under the Plan. In Mr. Galiette's opinion, the Plan should not have recognized either Mr. Xiao's or Ms. Chen's pre-participation service with Keystone because no merger occurred between LXEng and Keystone, nor were LXEng and Keystone engaged in the same line of work. Tr. 1, 2:46–48. When asked about Keystone's relationship to LXEng, Keystone's business operations generally, and about Ms. Chen's involvement with Keystone, Mr. Xiao's responses were oblique and evasive, and this Court accords such testimony little to no weight. Mr. Galiette's testimony was competent, credible, and not sufficiently rebutted by Mr. Fair or Mr. Xiao. Accordingly, this Court concludes that the Plan was not operated in accordance with its terms, which by itself, as Mr. Galiette credibly testified, would be enough to disqualify the Plan under the IRC. Tr. 1, 2:48–49.

D. The Debtor is Materially Responsible for the Plan's Substantial Compliance Failure

Having found that the Plan is not in compliance with the IRC, the Court turns to the final prong of this inquiry. Section 522(b)(4)(B)(ii)(II) provides that even if a plan is not in substantial compliance, Mr. Xiao's interest in the funds may still be exempt if he demonstrates that he is not materially responsible for that failure. Mr. Xiao bears the burden of proof to show that he was not materially responsible. *See In re Sharkey*, 563 B.R. 655, 666 (Bankr. E.D. Mich. 2017).

Mr. Xiao has not met his burden to show that he was not materially responsible for the Plan's substantial non-compliance with IRC Section 401. Not only has Mr. Xiao failed to present any credible evidence that he was not materially responsible for the qualification failures, but the overwhelming evidence shows that he was singularly responsible for such failures. It is undisputed that, from the Plan's formation to the Petition Date, Mr. Xiao was in sole control of LXEng, which he described as a "one man company." Tr. 2, 0:12–13. Since the time of Mr. Little's death, Mr. Xiao admitted that he was the CEO, COO, and managing member of LXEng. LXEng was the Plan Administrator. In addition, it was undisputed that Mr. Xiao was also the co-trustee of the Plan with Ms. Chen and signed each and every document creating, amending, and terminating the Plan as the principal of LXEng and co-trustee of the Plan. As was made patently clear during Mr. Galiette's testimony, "the Plan Administrator and the Plan sponsor are ultimately responsible for the Plan's failure to comply with the applicable IRC provisions, ERISA, and its own terms." Tr. 1, 3:15–16. This key testimony went unrebutted.

Mr. Xiao has instead blamed the Plan's lack of qualification on PenServ, the Plan's third party administrator, and certain other professionals. Such an argument is not supported by the facts of this case. As Mr. Galiette testified, a third-party administrator is a service provider that the Plan Administrator retains to perform specific functions with no discretionary authority, unless it has specifically agreed to undertake fiduciary responsibility, which PenServ did not do in connection with the Plan. Tr. 1, 1:52, 3:19–20. Mr. Ostuni, the president of PenServ, was clear in his testimony that PenServ "was unable to take any actions regarding the Plan without direction from LXEng as the Administrator, Mr. Xiao as the owner of LXEng, or LXEng's advisors and agents Mr. Cazes and Mr. Caputo." Tr. 1, 0:38–39. PenServ had no discretionary authority over the Plan, and could not make amendments, change its terms of participation, change the Plan Administrator or trustees, or terminate it. Only Mr. Xiao, acting through LXEng could do these things. Indeed, Mr. Ostuni testified that PenServ's role was to provide options to LXEng, but it was solely LXEng's decision of which option to choose. *See* ECF No. 538, at ¶81. He further testified that PenServ, on its own initiative, would never have advised LXEng or any other client to adopt anything similar to the 2009 Amendment. *Id.* at ¶55. That testimony also went unrebutted. Mr. Xiao's own expert clearly indicated, "a person is not exonerated from material responsibility for his elections and decisions by delegating administration to third parties." Tr. 2, 2:30–31.

Regarding the other professionals, namely, Mr. Caputo and Mr. Cazes, there was no evidence that they could have been materially responsible for the Plan's lack of compliance with the IRC. Mr. Cazes is a certified public accountant and Mr. Caputo is a certified financial planner. Although the Debtor conceded that the two were agents of LXEng, he did not present any evidence showing that these individuals had any decision-making power over the Plan.

As Mr. Xiao actively managed, supervised, and decided the affairs of the Plan as employer, manager, and co-trustee, he is materially responsible for its failure to comply with the pertinent sections of the IRC.

VI. CONCLUSION AND ORDER[8]

By all accounts, the Plan failures at issue in this case do not merely constitute technical defaults, but instead are operational failures that "are substantial violations of the core qualification requirements for a retirement" plan as set forth in the IRC. *See* IRC Section 401(a)(2). Given the timing of the 2009 and 2010 Amendments, and the subsequent freezing of the Plan, it appears that LXEng operated the Plan in order to solely benefit Mr. Xiao and his then spouse, Ms. Chen. According to the Treasury Regulations, a plan cannot act as a subterfuge for the distribution of profits to the owners of the employer. 26 C.F.R. § 1.401-1(b)(3). It appears to have been so here. Ex. T33, at p. 4.

The Debtor has persistently argued that because the IRC allows for the correction of plan defaults, LXEng could, at any time, make the necessary corrections. Indeed, both experts supported the position that the IRS has correction programs that allow for the remediation or correction of even disqualifying plan errors within a certain time-frame. However, it is clear from the record here that the Debtor failed to take a single corrective measure from the Petition Date to the time of trial, despite ostensibly having the opportunity to do so. Furthermore, as Mr. Galiette testified, the correction of operational failures would presumably require LXEng to pay fines to the IRS and provide benefits to some or all of the Debtor's former employees. Both LXEng and Mr. Xiao are in the midst of Chapter 7 bankruptcies, and have demonstrated insufficient financial abilities to fund any corrections to which they might otherwise have had access. The corrective action arguments are impracticable, futile, and unavailing.

[8] In his opposition to the Trustee's Motion for Summary Judgment, the Debtor initially advanced the argument that the Plan was subject to ERISA, and therefore exempt. However, the Debtor has seemingly abandoned this argument. The Debtor conceded in his Post Trial Brief, as did Mr. Fair at trial, that the Plan is not subject to ERISA. Therefore, the Court need not reach that issue. *See* ECF No. 54; Tr. 2, 2:12–13.

Finally, it is well-established law that a debtor's rights in a claimed exemption are established on the petition date. *See William J. Pasquina, P.C. v. Cunningham (In re Cunningham)*, 354 B.R. 547, 553 (D. Mass. 2006) ("It is hornbook bankruptcy law that a debtor's exemptions are determined as of the time of the filing of his petition. This means [that] the Court must focus only on the law and *facts* as they exist *on the date of filing the petition*.") (internal quotation marks and citations omitted), *aff'd*, 513 F.3d 318 (1st Cir. 2008); *Cisneros v. Kim (In re Kim)*, 257 B.R. 680, 687 (B.A.P. 9th Cir. 2000) ("[B]ankruptcy law is clear that debtor's exemption rights are fixed as of the petition date[.]") (citing *White v. Stump*, 266 U.S. 310 (1924)), *aff'd*, 35 F. App'x 592 (9th Cir. 2002).

Accordingly, the referenced funds under the LXEng Pension Plan, in the amount of $412,533.40, plus any interest or dividend accruals thereon,[9] are not exempted from the Debtor's bankruptcy estate.[10] The Trustee's Objection is SUSTAINED.

IT IS SO ORDERED at Hartford, Connecticut this 22nd day of August 2018.

James J. Tancredi
United States Bankruptcy Judge
District of Connecticut

[9] According to a Pension Report dated July 12, 2018 that was filed by Debtor's Counsel, the value of the Plan as of May 31, 2018 was $602,761.17 (ECF No. 554).
[10] In light of the Court's ruling, it need not reach the issue of whether the IRS would consider the Plan failures in this case to be "egregious."

2019

Commercial Law & Bankruptcy

THE YEAR IN REVIEW: CONSUMER BANKRUPTCY CASE LAW UPDATE

Kara S. Rescia, Esq.
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Attorney Rescia is grateful for the contributions of Paige M. Vaillancourt, an associate at Rescia Law, P.C. She is a 2018 graduate of Western New England University School of Law and is part of the firm's bankruptcy and insolvency practice.

DISCHARGEABILITY

***Lamar, Archer & Cofrin, LLP v. Appling*, 138 S.Ct. 1752 (2018)**

Appling hired Lamar, Archer & Cofrin, LLP (Lamar) to represent him as legal counsel for litigation involving his business. Appling became delinquent on his legal bills and owed Lamar $60,000. Lamar threatened to withdraw representation and place a lien on its work product until Appling paid. Appling told Lamar he expected a tax refund of approximately $100,000 and would use that to pay delinquent and future legal fees. Lamar relied on this statement and continued representing Appling. However, the Appling's actual joint refund amounted to $59,851 and they invested that money into their business. When Appling and Lamar next met, Appling told Lamar he had not yet received a refund. Relying on this statement, Lamar agreed to complete the litigation. Five years after Lamar sent its final invoice, Appling still had not paid and Lamar filed suit in Georgia state court. Lamar obtained a judgment in its favor of $104,179.60.

Appling and his wife subsequently filed for Chapter 7. Lamar initiated an adversary proceeding, arguing that the debt was non-dischargeable under 11 U.S.C. § 523(a)(2)(A), which bars the discharge of debts arising out of "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's . . . financial condition." Appling argued that his alleged misrepresentations were "statement[s] respecting [his] financial conditions" and, since they were not in writing, they were dischargeable under § 523(a)(2)(B). The bankruptcy court held that a statement regarding a single asset of the debtor does not represent the debtor's financial condition. After concluding that Appling had made two false representations on which Lamar justifiably relied, it found Appling's debt non-dischargeable. The district court affirmed and the Eleventh Circuit reversed, holding that a statement about a single asset may represent the debtor's financial condition. As such, because Appling's statements regarding his tax refunds were not in writing, the debt was not barred from discharge under § 523(a)(2)(B). The Supreme Court affirmed, stating that this interpretation of the code would not prejudice creditors since they could request representations in writing.

***Margulies v. USAA Cas. Ins. Co. (In re Margulies)*, 17-897(L), 17-1073(con) (2d Cir., 2018)**

Margulies was running late for a meeting with the governor of New York and when his car was stopped en route by Hough, who was acting as a flagman for a construction site. Margulies, becoming impatient, began to roll forward toward Hough and failed to apply the brakes until his car struck Hough. Margulies continued to his meeting after seeing Hough get up. Hough obtained a $4.8 million judgment and sued USAA, Margulies' insurance carrier, to collect. Margulies filed for Chapter 7 and Hough commenced an adversary proceeding seeking to have the debt to him declared non-dischargeable under 11 U.S.C. § 523(a)(6) as the result of willful and malicious misconduct or to hold USAA liable up to statutory limits because debt resulted from an "accident" within the meaning of the policy covering Margulies. The bankruptcy court held that the debt was non-dischargeable as it was the result of a willful and malicious act, but also that it was not an accident within the definition of the policy. The Second Circuit affirmed, agreeing with the bankruptcy court that because Margulies acted intentionally by failing to apply the brakes until his car hit Hough, the incident cannot be considered an accident as it did not flow from "a chain of unintended though expected or foreseeable events that occurred after an intentional act."

VIOLATION OF AUTOMATIC STAY/DISCHARGE INJUNCTION

Lorenzen v. Taggart (In re Taggart), 888 F.3d 438 (9th Cir., 2018), *cert. granted* January 4, 2019 (citation pending)

Taggart, a real-estate developer, allegedly transferred his 25% interest in a limited liability company (LLC) to his attorney in this case. Two other interest holders sued Taggart in Oregon state court, claiming the transfer violated the LLC's operating agreement since Taggart did not provide them with enough notice for them to exercise their right of first refusal. They also pursued attorney's fees. Before trial, Taggart filed a voluntary Chapter 7 and the state court action was stayed. After Taggart's discharge, the action proceeded and, prior to trial, Taggart moved to dismiss in light of the discharge. The state court denied the motion, finding Taggart a necessary party, but the parties agreed Taggart would not be subject to a monetary judgment. The court found in favor of the other interest holders, unwound the transfer, and expelled Taggart from the LLC. The other interest holders petitioned for legal fees, limiting the request to fees incurred after Taggart's discharge. The bankruptcy court allowed Taggart to reopen his case for the purpose of filing a motion to hold the interest holders and LLC in contempt for violating the discharge injunction.

The state court ruled Taggart could be held liable for legal fees since he "returned to the fray" after his bankruptcy. The bankruptcy court denied Taggart's motion for contempt in light of the state court's ruling. The district court reversed the bankruptcy court's ruling and remanded, finding that the discharge injunction did bar the claims for legal fees since Taggart's actions were not sufficient to find he "returned to the fray" and seeking a determination of whether there was a knowing violation of the injunction. The bankruptcy court found there was a knowing violation and held the creditors in contempt. The creditors appealed to the Bankruptcy Appellate Panel (BAP), which reversed the finding of contempt, reasoning that the creditors has a good faith belief that the injunction did not apply to their claims and therefore did not knowingly violate the injunction. During this time, the Oregon Court of Appeals reversed the trial court's decision, barring recovery of legal fees due to the injunction.

Taggart appealed the BAP's decision, arguing the BAP erroneously found the creditor were not in contempt because they did not knowingly violate the injunction. The creditors cross-appealed the district court's ruling that Taggart's actions were not sufficient to find he "returned to the fray." The Ninth Circuit affirmed the BAP's decision, stating that even if the subjective good faith belief is unreasonable it prevents a finding of contempt. The case has been granted certiorari in the Supreme Court of the United States and is scheduled to be heard in April.

Anderson v. Credit One Bank, N.A. (In re Anderson), 884 F.3d 382 (2d Cir., 2018)

Anderson held a credit card with Credit One Bank, N.A. (Credit One). He was delinquent on payments, Credit One charged off the debt, and reported the charge off to the credit reporting agencies. In 2014, Anderson filed a voluntary petition for Chapter 7 bankruptcy relief. He received his discharge, but Credit One refused to remove the charge-off notation from his credit report. The bankruptcy court allowed Anderson to reopen his case for the purpose of bringing a putative class action against Credit One alleging that Credit One's refusal to remove the charge-off notation was an attempt to coerce Anderson to pay a discharged debt. Credit One moved to stay proceedings in order to arbitrate the claim, in accordance with the cardholder agreement. The bankruptcy court held that the claim was not arbitrable because it went to the heart of the "fresh start" guarantees of the bankruptcy code and was thus a core bankruptcy proceeding. Credit One appealed under the Federal Arbitration Act and the United States District Court for the Southern District of New York agreed with the bankruptcy court. The Second Circuit affirmed, stating that a "fresh start" afforded by the discharge of debts is the principal goal of the Bankruptcy Code and as such is a core proceeding of bankruptcy law. The court stated that a core proceeding is one that involves pressing concerns, such as enforcement of discharge, and the court has discretion in such cases to deny arbitration. If a case does not involve a core proceeding, then federal policy strongly favors arbitration and litigation would be stayed.

***Beckford v. Romano (In re Beckford),* No. 13-20749 (AMN) (Bankr. D. Conn. 2018)**

The Debtor filed a motion for contempt against Attorney Romano seeking damages for violation of the automatic stay. Attorney Romano had filed a motion for contempt against the Debtor in Connecticut state court while the automatic stay was in place for failure to pay a Home Depot bill as required by a judgment in the Debtor's divorce case. Attorney Romano filed a second motion for contempt for the same after the Debtor received his discharge. The bankruptcy court had entered a decision in 2017 holding Attorney Romano in contempt for violating the automatic stay, but found no violation of the discharge injunction. After an evidentiary hearing to assess actual damages, the court awarded the Debtor $192.00 for the amount of wages he lost on the day he attended a hearing on the first motion for contempt, even though Attorney Romano testified and presented evidence supporting his testimony that he did not mark the first motion for contempt as "ready," as required by state court, and therefore the Debtor was not required to attend the hearing. The court "decline[d] to place the procedural burden" on the Debtor as a pro se party unfamiliar with state court procedure.

COLLEGE CLAW-BACKS

Conn. Gen. Stat. § 52-552i (2017)

> (f) A transfer or obligation is not voidable under subdivision (2) of subsection (a) of section 52-552e or section 52-552f against an institution of higher education, as defined in 20 USC 1001, if the transfer was made or obligation incurred by a parent or guardian on behalf of a minor or adult child in furtherance of the child's undergraduate education.

Boscarino v. Bd. of Trustees of Conn. State Univ. Sys. (In re Knight), No. 15-21646 (JJT) (Bankr. D. Conn. 2017)

The Debtor's son was enrolled as a student at Central Connecticut State University (CCSU). The Trustee sought recovery of all tuition payments made by the Debtor on behalf of her son after he reached the age of majority, which is eighteen in Connecticut, as constructive fraudulent transfers. The court found that the Debtor "did not receive any legally cognizable value . . . and therefore could not have received reasonably equivalent value" under 11 U.S.C. § 548(d)(2)(A), which defines value as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but [it] does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor." The court stated that this definition limited "value" "to economic benefits that preserve the net worth of the debtor's estate for the benefit of creditors." (citing *Rubin v. Manufacturers Hanover Tr. Co.*, 661 F.2d 979, 992 (2d Cir. 1981)).

Geltzer v. Oberlin College (In re Sterman), No. 18-01015 (MG) (Bankr. S.D.N.Y. 2018)

The Trustee sought recovery of tuition paid by the Debtors for the benefit of their adult daughters as constructive fraudulent transfers. The court, citing *In re Knight* as a supporting case, found that there was no reasonably equivalent value to the Debtors in exchange for the payments under New York law or the Bankruptcy Code. This case makes the distinction that the age of majority in New York is twenty-one and transfers can be avoided after that age, but not before.

Novak v. University of Miami (In re Demitrus), 586 B.R. 88 (Bankr. D. Conn. 2018)

The Trustee sought recovery of several payments made by the Debtor to the University of Miami (University) via a Federal Direct Parent PLUS Loan on behalf of her adult daughter before filing bankruptcy. The Trustee claimed these payments constituted constructive fraudulent transfers under 11 U.S.C. §§ 548(a)(1)(B), 550, and 551, as well as a UFTA Constructive Fraudulent Transfer under 11 U.S.C. § 544(b)(1) and Conn. Gen. Stat. §§ 52-552e(a)(2) (CUFTA). The University filed a motion to dismiss. The court relied on *Eisenberg v. Pennsylvania State University (In re Lewis)*, 574 B.R. 536 (Bankr. E.D. Pa. 2017) for its reasoning and conclusion. The court granted the motion, holding (1) that the funds were not property of the estate because the Debtor had no interest in or possession of the funds, based on the finding that the Debtor never had dominion or control over the funds, which were disbursed to the University directly by the loan program; and (2) the "federal statutory and regulatory scheme regulating [Department of Education] loans" did not support the Trustee's claims under applicable non-bankruptcy law.

Roumeliotis v. Johnson & Wales Univ. (In re Demauro), No. 15-03011 (AMN) (Bankr. D. Conn. 2018)

Before filing for bankruptcy, the Debtors allegedly made two payments to Johnson & Wales University (University) at or around the two year statutory look-back period and six others before said period on behalf of their adult daughter. The Trustee sought recovery of the two payments made at or around the two year period under 11 U.S.C. §§ 548(a)(1)(B), 550(a), and

551 as constructive fraudulent transfers. The Trustee sought recovery of the six other payments under 11 U.S.C. § 544(b)(1) and Connecticut Uniform Fraudulent Transfer Act (CUFTA) as constructive fraudulent transfers. Initially, the University moved to dismiss, arguing that all funds, which were Direct PLUS Loan proceeds, "were not property of [the Debtors] and not subject to § 548 because they were restricted funds disbursed under the Federal Direct PLUS Loan program." It also argued that one of the two payments in the Trustee's first count fell outside the two-year period, with which the court agreed and struck. The court ordered the motion to dismiss to be heard as a motion for summary judgment and subsequently denied the motion. The University filed this motion for summary judgment, arguing (1) the Debtors "did not have a property interest in the Federal Direct PLUS Loan proceeds and did not make the transfers;" (2) the University was entitled to a good faith defense as it was not the initial transferee; and (3) the Debtors received reasonably equivalent value. The court, relying on the reasoning and holding of *In re Demitrus*, granted the motion, holding that the proceeds did not "constitute an interest of the debtor in property subject to avoidance pursuant to §§ 544 and 548" as they were disbursed directly to the University and could not be used by the Debtors for anything other than the limited purpose of paying tuition and "other qualified education-related expenses."

***Pergament v. Hofstra Univ. (In re Adamo)*, 582 B.R. 267 (Bankr. E.D.N.Y. 2018), *vacated and remanded Pergament v. Brooklyn Law School*, No. 1:18-CV-2204 (ARR) (E.D.N.Y. Jan. 4, 2019)**

The Trustee sought recovery of pre-petition tuition payments to Hofstra University and Fairfield University as constructive fraudulent transfers under 11 U.S.C. §§ 548(a)(1)(B) and 544, as well as New York Debtor & Creditor Law §§ 273, 273-a, and 285, that the Debtor made on behalf of his adult children. The Trustee also sought recovery of post-petition transfers made by the Debtor to the previously mentioned universities and Brooklyn Law School as unauthorized transfers made by a Chapter 11 debtor-in-possession under 11 U.S.C. § 549. The Trustee argued that the Debtor did not have an obligation to provide an education to his children after the age of eighteen, that the Debtor did not receive reasonably equivalent value, and that the post-petition transfers were not made in the ordinary course of business. The universities argued that the Debtor received reasonably equivalent value, the post-petition payments were not unauthorized, public policy matters should not support avoidance, and that the good faith defense available to subsequent transferees under 11 U.S.C. § 550(b) should apply. The bankruptcy court denied the Trustee's motion for summary judgment and granted the universities' motion for the same, finding that the universities were subsequent transferees and entitled to the good faith defense since the children were entitled to full refunds of the money paid through the universities' portals up until they enrolled in classes and the funds were applied to a tuition bill. This, the bankruptcy court reasoned, evidenced that the universities were "mere conduits" with no dominion or control over the funds until they were applied and provided value to the children.

In the appeal, the district court made the distinction that the universities were initial transferees once the schools no longer had any obligation to issue a refund, making the timing of the transfers versus the filing of the bankruptcy factors in the determination of whether the universities were initial or subsequent transferees. It vacated and remanded with instructions to determine which payments were refundable and therefore protected by the bankruptcy court's reasoning.

***Mangan v. Univ. of Conn. (In re Hamadi)*, No. 17-02090 (JJT) (Bankr. D. Conn. 2019)**

The Debtors' adult son, Ali, was a University of Connecticut (UConn) student. UConn utilizes an online portal system for tuition billing and payment. UConn credits payments to a student's account to the student and issues any refunds to the student, regardless of whether a student or third-party paid. After a certain date, a student is entitled only to a portion of any sum paid toward the account or no refund at all. Ali's account was in his name only and the Debtor's had no control over the account. The Debtor Husband made four payments to the account in the two years preceding filing. After filing, the Debtor Husband made three additional payments to the account, which UConn accepted in good faith. The Trustee, sought recovery sought recovery of the pre-petition payments under 11 U.S.C. §§ 548(a)(1)(B), 550, and 551 as constructive fraudulent conveyances. UConn asserted, first, that Ali was an initial transferee under 11 U.S.C. § 550(b)(1) and it was an immediate transferee who took the payments for value, in good faith, with without knowledge of the voidability, and, second, that tuition payments made after the filing date were post-petition. The Trustee argued UConn became an initial transferee once the Debtor Husband deposited funds into Ali's account, which evidenced UConn's dominion and control. The court ruled that UConn was an initial transferee as to any non-refundable payments, the transfers of which could be avoided by the Trustee, and an immediate transferee as to refundable payments, as to which UConn could assert a good faith defense. The court also ruled that the post-petition payments were not avoidable under 11 U.S.C. § 548.

<u>IN REM RELIEF</u>

***T&M Building Co., Inc. v. Edwards*, No. 19-20016 (JJT) (Bankr. D. Conn. 2019)**

T&M Building Co., Inc. (T&M) moved for relief from the automatic stay and in rem relief in the Debtor's Chapter 11 case. The Debtor proposed a Chapter 11 plan where he would pay $900,000 over a ten-year period on T&M's matured note and mortgage on his house, which was valued at $352,000. There had been two previous bankruptcy filings over the two-and-a-half years preceding this filing, all of which had been filed on the eve of foreclosure, law days, or vesting of title. The court granted T&M relief under 11 U.S.C. §§ 362(d)(1) and (4) on the bases that the proposed plan was "patently unconfirmable under U.S.C. §§ 1123 and 1129" because (1) the Debtor's plan to work 80-hour weeks over ten years was unsustainable as a human; (2) the objective of saving a home worth $352,000 by paying $900,000 was "improvident, foolish, and unreasonable;" (3) the modifications proposed were expressly prohibited by 11 U.S.C. § 1123(b)(5); and (4) the plan failed to satisfy 11 U.S.C. §§ 129(a)(1), (2), (3), (7), and (11).

***In re Valerie I. Carlsen*, No. 19-20366 (JJT) (Bankr. D. Conn. 2019)**

The Debtor filed four bankruptcies prior to this Chapter 13. She filed this case after a foreclosure sale of her home, but before the Superior Court approved the prevailing bid in the sale. The Debtor moved for relief from the in rem order entered in her fourth case, claiming her two attorneys did not have her signature or authority to file her third and fourth cases, giving her good and sufficient cause to vacate the order and allow her to propose a plan in her fifth filed case. The court denied her motion and sustained the Town of East Windsor's objection on the bases that the Debtor (1) failed to demonstrate good cause; (2) achieved the goal clearly communicated to her attorneys by preventing imminent foreclosure of her home with her third and fourth filings, the fourth in which she obtained a credit counseling certificate and filed a motion to reopen, all of which evidences her knowledge and authorization of the filings; (3) should be equitably estopped from vacating the order to prevent more "harm, detriment, injury, delay, and expense to the Town of East Windsor;" (4) failed to demonstrate clean hands with her years of deficiencies, lack of payment of taxes, and serial filings; and (5) should be denied relief on the basis of laches since she had a year of notice of the order to file her motion to vacate and did so at the last minute.

EXEMPTIONS

Maresca v. Donovan, No. 16-30755 (AMN) (Bankr. D. Conn. 2018)

The Debtor filed a motion to avoid two judicial liens, arguing they impaired her exemption under 11 U.S.C. § 522(d)(1) in real property periodically used as a dwelling by her dependent child under 11 U.S.C. § 522(f). The court disposed of the "state law" approach to statutory interpretation since Connecticut law is silent on how to proceed when a dwelling is used as a residence by a debtor's dependent, but not the debtor. The court used the "plain meaning" approach to reason that Congress intended the exemption to encompass a "wider range of exempt property" than state law, as evidenced by its use of "residence" instead of "primary residence." The Debtor's ex-husband, who was awarded joint custody of the child, resided at the property. The child spent time with both parents, even though the child was at the property only periodically, and went to school in the town where the property was located. The court used these facts to determine that the Debtor was entitled to the exemption in her interest in the property.

Chorches v. Xiao (In re Xiao), No. 13-51186 (JJT) (Bankr. D. Conn. 2018)

The Debtor initially claimed an exemption in a pension plan with a value of $414,533.40 under 11 U.S.C. § 522(d)(10), but later amended to claim the exemption under 11 U.S.C. § 522(d)(12). In his schedules, the Debtor disclosed a 100% interest in the company holding the pension plan, stating the value of that company as $0.00. The court found that the plan was not exempt from the estate as retirement funds because it (1) was not protected by determination letters issued by the Internal Revenue Service before several discretionary amendments to the plan and (2) did not comply with the Internal Revenue Code's requirements that the plan (a) be permanent, (b) meet minimum participation regulations, such as IRC § 401(a)(26), (c) meet exclusive benefit and non-discrimination requirements under IRC §§ 401(a)(2) and (a)(4), and (d) be operated according to its own terms. The court did not find the Debtor's testimony that he relied solely on his experts to form and administer the plan. It stated that that plan essentially "act[ed] as a subterfuge [to] distribute profits" to the Debtor and his wife at the time, in violation of 26 C.F.R. § 1.401-1(b)(3).

Recent Developments in Business Bankruptcy

Timeframe Covered: March 2018 – present

Presented by:

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Introduction

- Supreme Court cases
- Second Circuit cases
- Selected out of circuit cases
- Connecticut Cases
- Selected other notable cases
- Selected legislation and pending cases

There are many interesting and relevant cases that have been released in the past year. This is but a tiny sample. You should attend ABA Business Bankruptcy Committee, ABI, TMA, or other programs that provide further case reviews, in addition to constant self study!

Green & Sklarz LLC

Supreme Court

***Merit Mgmt. Group, LP v. FTI Consulting, Inc.*, 138 S. Ct. 883 (2018)**

Facts:
- Debtor and Bedford Downs entered into an arrangement where if Debtor was granted a harness racing license, Debtor would purchase Bedford Downs stock for $55 million.
- Debtor got the license and through a variety of financial intermediates and escrow agents, wired the $55 million to Citizens Bank.
- "Citizens Bank disbursed the $55 million over two installments according to the agreement, of which [ ] Merit [Management] received $16.5 million."
- The liquidation trustee sued Merit Management to recover the $16.5 million. The trustee claimed that Debtor "significantly overpaid" for the Bedford Downs stock.

Issues: Whether the "securities safe harbor" under 546(e) exempts Merit Management from transferee liability as the funds were transited through a financial institution.

Holdings:
- "The language of § 546(e), the specific context in which that language is used, and the broader statutory structure all support the conclusion that the relevant transfer for purposes of the § 546(e) safe-harbor inquiry is the overarching transfer that the trustee seeks to avoid under one of the substantive avoidance provisions."
- "[W]e conclude that the relevant transfer for purposes of the § 546(e) safe harbor is the same transfer that the trustee seeks to avoid pursuant to its substantive avoiding powers."
- Moving money through a financial intermediary that is an escrow agent or other conduit does not implication the 546(e) safe harbor

Second Circuit

***In re Picard, Tr. for Liquidation of Bernard L. Madoff Inv. Sec. LLC*, 917 F.3d 85, 91 (2d Cir. 2019)**

Facts:

- Bernie Madoff stole money from some people and gave it to others.
- Some of the people were not from the US and invested in funds that were not in the US either, but those funds either invested in other entities that invested with Madoff, or in Madoff itself. These foreigners were net winners.
- The trustee sued the foreigners for fraudulent transfer in the SDNY.

Issues:

- Whether the foreign nature of the defendants precludes US bankruptcy court jurisdiction since the defendants never transacted with a US based entity the recovery (550) would take place overseas.
- Whether rules of comity require the trustee to seek recovery in the foreign jurisdiction, not SDNY

Holding:

- Look to where the transfer occurred (548) not where the recovery happens (550): “The relevant conduct in these actions is the debtor’s fraudulent *transfer* of property, not the transferee’s *receipt* of property. When a domestic debtor commits fraud by transferring property from a U.S. bank account, the conduct that § 550(a) regulates takes place in the United States.”
- Intentional comity does not require deferral by the US courts. There is no compelling interest to do so.
- Consistent with *Merit Management* – look at the economic substance of the transaction, not the bells and whistles.

Second Circuit (cont.)

***PACA Tr. Creditors of Lenny Perry's Produce, Inc. v. Genecco Produce Inc.*,**
913 F.3d 268 (2d Cir. 2019)

Facts:

- Plaintiff and Defendant (GPI) were both creditors of a bankrupt produce seller, LPP.
- GPI and LPP sold produce to each other also.
- "Instead of paying each other after each transaction, GPI and LPP accumulated mutual debts intended to offset one another"
- When LPP filed for bankruptcy LPP owed ~$263,000 to GPI, and GPI owed ~$204,000 to LPP, and, thus, there was a net balance of ~$58,000 in GPI's favor.
- After LPP filed for bankruptcy, Plaintiffs brought an adversary proceeding against GPI for the full $204,000, arguing that it was part of PACA trust funds.

Issue: Whether GPI entitled to assert a right of set off under 553.

Holding:

- "Because PACA assets are held in trust for the benefit of unpaid produce suppliers generally and never become part of a bankruptcy estate, and because such PACA creditors enjoy priority over non-PACA creditors, the defendants' offset defense under section 553 of the U.S. Bankruptcy Code and New York State law is unavailing."
- "The defendants' reliance on bankruptcy law to defend against PACA claims is misplaced. To the extent the disputed assets represent PACA Trust assets, they are held outside the bankruptcy estate, and their disposition is, therefore, governed by trust law rather than bankruptcy law."
- GPI is still entitled to a pro rata share of the PACA trust proceeds, as they are themselves a PACA supplier.

GREEN & SKLARZ LLC

Second Circuit (cont.)

***FTC v. Moses*, 913 F.3d 297 (2d Cir. 2019)**

- Defendants were the businesses and owners of companies that bought-up payday loans and collected on them.
- "At the Corporate Defendants' behest, nearly all of their approximately twenty-five employee-debt collectors would routinely contact debtors by telephone and falsely identify themselves as 'processors,' 'officers,' or 'investigators' from a 'fraud unit' or 'fraud division,' then accuse debtors of check fraud or a related crime and threaten them with criminal prosecution if they did not pay their debts. On some occasions, collectors called friends, family members, employers, or co-workers of debtors, telling them that the debtors owed a debt, had committed a crime in failing to pay it, and faced possible legal repercussions. When debtors or other interested parties sought further information about the debt, collectors typically refused to provide it."
- The FTC sought various remedies, including disgorgement of recoveries for ~$10 million.
- The defendants raised no substantive defenses other than, essentially, individuals are not liable for corporate conduct.
- The moral: some times bad things happen to bad people. Also, don't impersonate law enforcement personnel when you are a sleazy debt collector.

Second Circuit (cont.)

***In re Murray*, 900 F.3d 53, 56 (2d Cir. 2018):** Single creditor involuntary dismissed as it was a tactic to collect on a debt owed in a two-party dispute.

- Augment as to why a 1-creditor IV-BK is okay: "absent a finding of bad faith because Wilk Auslander's interests as a creditor will be prejudiced if it is denied access to the remedies available in bankruptcy court."
- Specifically, the petitioning creditor wanted to have a trustee sell the house that debtor owned with his wife to satisfy the creditor's claims, which creditor could not do in state court because of NY's rules concerning tenancy by the entirety.
- Holding: "This case… involves only one creditor and no risk of asset depletion in favor of other creditors. Wilk Auslander's preference for bankruptcy remedies to solve a two-party dispute cannot outweigh the lack of any other bankruptcy-related purpose."

Other Circuits

***Kaye v. Blue Bell Creameries, Inc.*, 889 F.3d 1178 (11th Cir. 2018) (subsequent new value need not remain unpaid)**

Issue:

- Whether use of a new value defense (547(c)(4)), requires that the new value given (i.e. good, services) delivered after receipt of a preference payment, must themselves be uncompensated.
- *Corollary questions not expressly answered:* Whether unused new value can be carried over.

The New Value Defense – 547(c)(4):

"The trustee may not avoid under this section a transfer… (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor- (A) not secured by an otherwise unavoidable security interest; and (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor…."

"Remain unpaid" vs. "subsequent advance" approach:

- *Remains unpaid*: Any new value advanced by creditor must remain unpaid as of the petition date.
- *Subsequent advance*: Any new value advanced after a preference payment reduces preference exposure irrespective of whether it was later paid by debtor.

Holding:

- "Nothing in the language of § 547(c)(4) indicates that an offset to a creditor's § 547(b) preference liability is available only for new value that remains unpaid."
- "[T]he statute only excludes 'paid' new value that is paid for with 'an otherwise unavoidable transfer… Therefore, so long as the transfer that pays for the new value is itself avoidable, that transfer is not a barrier [to the defense]."
- "If new value must remain unpaid, then vendors who sense that a debtor is in financial difficulty will have an incentive to stop delivering any goods because any payments they receive, after extension of a short-term period of credit on these deliveries, might be avoided, and thereby clawed back by the trustee in bankruptcy."

Other Circuits (cont.)

***In re Ultra Petroleum Corp.*, 575 B.R. 361 (Bankr. S.D. Tex 2017), rev'd in part, vacated in part by 913 F.3d 533 (5th Cir. 2019), petition for rehearing *en banc* filed (5th Cir. Jan. 31, 2019) (No. 17-20793) (make whole premiums and when they are compensable)**

Jargon defined:

- *Make Whole Premium*: An amount intended to ensure that a lender is compensated for lost interest if a loan is repaid prior to the maturity date.
- *Perfect Tender in Time*: Unless a note contains a prepayment provision, the holder does not need to accept early payment.
- *Solvent Debtor Exception:* A pre-code English law concept that when a debtor is solvent they get interest to the extent of the contractual undertaking.

Facts:

- On account of a unique set of circumstance (rise in oil prices) debtor saw itself go from insolvent to paying a 100% return to creditors.
- One secured creditor lent funds to debtor under a credit facility with a provision that required payment of foregone interest if prepayment was made.
- Since the plan did not provide for payment of that make whole amount, the creditor voted against the plan.

Other Circuits (cont.)

In re Ultra Petroleum Corp., (cont.)

Issue:

- Whether a secured creditor is impaired if their debt is paid in fall, but they are not paid unmatured future interest, which is compensable under the credit documents.
- If the Bankruptcy Code does not permit a creditor to receive payment, is the creditor impaired where the plan pays the creditor in derogation of the credit documents, but in conformity with the Bankruptcy Code: "In other words, if a plan does not provide the creditor with all it would receive under state law, [is] the creditor is impaired even if the Code disallows something state law would otherwise provide outside of bankruptcy."

Analysis:

- *Section 502(b)(2)*: Precludes the award of post-petition interest that is *part of a creditor's claim*.
- *Section 506(b):* Allows a creditor to recover interest at its contract rate, if the creditor is oversecured
- *Section 726(a)(5):* Allows payment of interest at the *legal rate* on any claim paid under the 726 waterfall rules. Thus, "[i] the debtor's estate is sufficient to pay items 1 through 4, then creditors should also get post-petition interest (item 5) before the debtor can recover any surplus (item 6)."
- *Is unmatured (make whole) post-petition interest part of the claim or interest on the claim*: "[T]he Code changed the source of recoverable post-petition interest. The pre-Code solvent-debtor exception allowed creditors to recover interest *as part of* a claim. The Code, by contrast, requires solvent debtors to pay post-petition interest *on* a claim.
  - Part of the Claim: Interest the creditor receives on account of the debtor having enough resources to pay the interest.
  - Interest on the Claim: Interest that arises on account of having a claim.

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Other Circuits (cont.)

<u>In re Ultra Petroleum Corp., (cont.)</u>

<u>Analysis (cont.)</u>

- Therefore, the amount of interest allowable under 726(a)(5) could either be the statutory rate or the contract rate. What does the term "legal rate" mean?

<u>Holdings</u>

- *Are make whole amounts allowed under 502?* "Section 502(b)(2) thus disallows any claim that is the economic equivalent of unmatured interest." Since the make whole amount "is calculated by subtracting the accelerated principal from the discounted value of the future principal and interest payments. That captures the value of the interest the Noteholders would have eventually received if the Notes had not been prepaid."
- *Does 502(b)(2)'s voiding provision apply pot a solvent debtor?* Does the "pre-Code solvent debtor exception survive the enactment of 502(b)(2)?"
    - The Fifth Circuit remanded on this issue for further consideration but did not look favorably that it does.
- *What post-petition interest is a creditor of a solvent debtor allowed under 506(b) and 726(a)(5)?* "The creditors here have no *legal* right to post-petition interest at the default rates. They do not point to a New York law requiring them to receive post-petition interest. Nor do they have a *contractual* right to such interest. The contractual rates at issue here governed interest paid on amounts owed under the contract, not interest on a bankruptcy award. The contracts did not purport to fix an interest rate that would govern if the parties proceeded to protracted litigation, obtained the equivalent of a 'judgment' in bankruptcy court, and then a court awarded interest. But they might have an *equitable* right to post-petition interest."
    - Again, as the bankruptcy court did not specifically address this issue, the Fifth Circuit remanded, but pretty clearly telegraphed that the contractual rate of interest was not the appropriate amount.

Connecticut District and Bankruptcy Court

***In re Neri Bros. Constr. Corp.*, 593 B.R. 100, 153 (Bankr. D. Conn. 2018) (Nevins)**

- Case was converted from chapter 11 to 7: Trustee argued the rental of equipment owned by Debtor to a third-party for a below market price was an improper postpetition transfer as the use was not approved under § 363(b) during the chapter 11 case.
- Issue: is a transaction that is requires 363(b) approval recoverable under 549 after the case converts, if 363 approval was *not* obtained?

Holdings:

- “The Court concludes that the Trustee has failed to demonstrate that a construction company renting out its equipment is not outside of the expectations of creditors or unusual in the construction industry.”
- “The Trustee's claims center around whether the transaction is unreasonable from a business judgment perspective. This is the provenance of a fraudulent transfer analysis with the higher standard of proof that entails, rather than a claim for an unauthorized post-petition transfer.”

***Small v. Neighborhood Hous. Services of New Haven, Inc.*, 589 B.R. 31, 32 (D. Conn. 2018) (Myers affirming Nevins)**

- Chapter 7 schedules listed creditor of entity in which a second-tier entity 50% owned by debtor held an interest for notice purposes only.
- Issue: Whether the entity has standing in the bankruptcy case and more specifically to seek a 2004 examination.

Holdings:

- Because the entity was scheduled, even though just as a notice party, they have party-in-interest standing.
- Because the entity asserted it held a direct claim against debtor, entity had party in interest standing, even though it did not file a timely proof of claim.

Connecticut District and Bankruptcy Court

***Coan v. Dunne*, 2019 WL 302674 (Bankr. D. Conn. Jan. 22, 2019) (Manning)**

- Trustee sought to retain 2 law firms to assist with prosecuting proceedings in the US and Ireland.
- The US law firm previously represented defendants and related entities in potential adversary proceedings.
- The defendants in the adversary proceeding objected to the retention of the US law firm.

Holdings:

- Because the representation of the US law firm was "substantially related" to the pending litigation, the prior representation conflict rules under Rules of Professional Conduct 1.9 apply.
- The Court concluded that "there is a substantial risk that confidential factual information that would normally have been disclosed by [client to proposed trustee's counsel, a former lawyer for the defendant] would materially advance the Trustee's position in this action now before me." Thus the court disapproved the retention.

***In re SIMA Int'l, Inc.*, 2018 WL 2293705 (Bankr. D. Conn. May 17, 2018) (Tancredi)**

- Debtor was the sole owner of certain intellectual property called SIMA.
- Debtor entered into an exclusive license agreement with MHI
- Debtor filed C-7 and trustee sought to reject license agreement with MHI.
- The parties agree that the license agreement is executory, and that MHI has rights under 365(n) to retain the license agreement.
- The parties disputed the scope of what was covered by the intellectual property license, and whether that limited the Trustee's right to sell or further license the underlying SIMA trademarks.

Issue: Whether the license agreement permits the use of Debtor's trademarks post-rejection.

Holdings:

- "There is a circuit split with respect to the question of whether a trademark licensee can continue to retain the license post-rejection of the agreement." "The effect of rejection of an executory contract or unexpired lease is limited to a breach or abandonment by the trustee or debtor in possession rather than a complete termination."
- The use of the SIMA trademark is central to the effective use of the license implementation of the license agreement.
- Thus, the Trustee can reject the contract, but 365(n) allows the licensee to perform under the agreement.
- *Note*, Judge Tancredi explicitly declined to follow *In re Tempnology, LLC*, 879 F.3d 389 (1st Cir. 2018) (rejection of a trademark license strips the exclusive use of the trademark regardless of 365(n)), *cert granted,* 139 S. Ct. 397.

Connecticut District and Bankruptcy Court

***In re Republic, LLC*, 2018 WL 3203869 (Bankr. D. Conn. Jun. 26, 2018) (Manning)**

- Debtor's principal did not appear for chapter 11 status conference. Debtor did not file schedules or comply with other deadlines.
- Holding: Court dismissed case *sua sponte* for cause given Debtor's failure to comply with basic requirements for administering a chapter 11. And, Debtor's principals likely committed various kinds of fraud.

***In re First Connecticut Consulting Group, Inc.*, 2018 WL 2121531 (Bankr. D. Conn. May 7, 2018) (Tancredi)**

- Jim Licata sought to reconvert a case from Chapter 7 to 11 more than a decade after the initial conversion. He lost, so he sought reconsideration.
- As grounds he asserted there was new evidence available and errors of law.

Holdings:

- "Quite simply, Licata has not presented new evidence. At best, he has alleged the existence of certain purported evidence[4] that has no apparent bearing on the legal questions before the Court. "
- "No amount of contextualizing excuses Licata's criminal conviction for wire fraud during the pendency of these cases, or his facilitation of multiple dubious, if not outright fraudulent transfers and efforts to impede the administration of these Chapter 7 estates."

Connecticut District and Bankruptcy Court

***In re Ortega's Mexican Rest.*, 2019 WL 417852 (Bankr. D. Conn. Feb. 1, 2019) (Tancredi)**

- Happy Rock (HR) agreed to pay $20,000 to purchase ~$27,000 worth of Debtor's future AR. A partition of the amount, ~$11,000, was earmarked for to satisfy an outstanding balance due under an earlier arrangement.
- The agreement does not allow recourse for non-payment of AR, except for violation of representations and warranties. Thus, non-payment is not a basis to "put" the purchased receivable.
- Issue: Whether a "merchant sales agreement" was a loan or true purchase of accounts receivable?
- Holding: Applying New York law, none of the factors signifying that the obligation is a loan are present. Thus, the agreement was a purchase and sale arrangement, not a loan.

***In re Clinton Nurseries, Inc.*, 2018 WL 2293554 (Bankr. D. Conn. May 17, 2018) (Tancredi)**

- Creditor "leased" various equipment and other goods and services to Debtors. Creditor also filed UCC-1s and claimed to be a secured creditor too.
- Creditor filed an application to compel payment of administrative rent claims
- Debtors and Committee objected arguing that the arrangement was not a true lease but really a disguised financing arrangement.

Holdings:

- The nature of the goods demonstrated, in part, that the arrangement was not really a lease.
- Applying the "Bright Line Test" under Michigan law (which is the same as Connecticut or most other law on this topic), the transaction was really a disguised security interest because there was only nominal value left in the property at the end of the lease term.
- The interest of the parties (lease vs. financing arrangement) are determined at "the date of the transaction, rather than a future date…."

Connecticut District and Bankruptcy Court

In re: Jackson, Adv. Proc. No. 17-2005 (Bankr. D. Conn. Mar. 1, 2019) (Nevins)

- 50 Cent filed BK because he was about to have a large judgment rendered against him for revenge porn (the "Leviston Case").
- A chapter 11 plan was confirmed.
- Thereafter, 50 Cent sued his former lawyers hired to defend the Leviston Case for malpractice and related claims, including excessive legal fees.
- The defendants moved to dismiss.

Holdings:

- The Court dismissed all of the claims with prejudice with the exception of a claim for failing to depose an internet provider: "The sole allegation in Count Two that survives the pleading stage is the allegation that the Defendants committed malpractice by failing to conduct and preserve discovery of Mr. Ross, Mr. Murray, or the Internet Provider which, if conducted, would have mitigated the amount of damages awarded against Mr. Jackson."
- Judge Nevins does not appear to view the case as viable: "This is not to say that Mr. Jackson will be successful on his malpractice claim, but that the allegation – that the Defendants failed to conduct and preserve testimony from the three witnesses, which would have mitigated Mr. Jackson's damages -- survives the motion to dismiss. Mr. Jackson must, nonetheless, prove that the Defendants' conduct was negligent and that but for the Defendants' negligent conduct, Mr. Jackson would not have suffered some amount of actual and ascertainable damages. Failure or inability to do so may result in summary judgment entering in favor of the Defendants."

Other Notable Decisions

***In re* *Motors Liquidation Co.*, 2019 WL 367170, at *3 (Bankr. S.D.N.Y. Jan. 29, 2019)**

- In the aftermath of the accidental release of the lien securing the main "Old GM" credit facility, were post-petition payments made on the belief that the lien was valid subject to avoidance.
- Issue: is earmarking a defense to a § 549 avoidable transfer?
- Holding: While in certain circumstances earmarking may constitute a defense it is inapplicable here. "[T]the Court concludes that the defense is not available in this case. The DIP financing was not subject to a clear obligation to use the money to pay the Term Lenders. While the DIP Order authorized the repayment to the Term Lenders, it was expressly subject to challenge and recovery based on the extent, validity and priority of the liens securing the Term Loan. Furthermore, the repayment to the Term Lenders diminished Old GM's estate. Accordingly, partial summary judgment is awarded to the AAT and the Term Lenders' earmarking defense is dismissed as a matter of law."

Other Notable Decisions

***In re 1141 Realty Owner LLC*, No. 18-12341 (SMB), 2019 WL 1270818 (Bankr. S.D.N.Y. Mar. 18, 2019) (make whole premiums)**

Facts:

- Debtor owns a hotel
- Hotel is encumbered by a mortgage. Mortgage contains a "make whole" (yield maintenance" provision
- Creditor accelerated the mortgage for certain non-monetary defaults.
- The mortgage did not permit prepayment. Also, if there was an event of default: "payment of all or any part of the Debt is tendered by Borrower or otherwise recovered by Lender, such tender or recovery *shall be deemed a voluntary prepayment* by Borrower in violation of the prohibition against prepayment set forth in Section 2.3.1 and Borrower shall pay, in addition to the Debt, (i) an amount equal to the *Yield Maintenance Default Premium*…."
- Creditor filed a POC that included the make whole amount.

Debtors Argument:

- "[C]ourts will only uphold prepayment premiums after acceleration where the applicable loan agreement expressly provides that the premium is due following an acceleration and uses the word 'acceleration,' or some other variant."
- Because the debt was accelerated there cannot be a prepayment penalty

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Other Notable Decisions

1141 Realty Owner LLC (cont.)

Analysis:

- Generally, a lender that accelerates a loan following a default forfeits the right to a prepayment premium because the acceleration advances the maturity date, and by definition, the loan cannot be prepaid.
- Exceptions
  - First, if a clear and unambiguous clause requires the payment of the prepayment premium even after default and acceleration, the clause will be analyzed as a liquidated damages clause.
  - Second, if the borrower intentionally defaults to trigger the acceleration and "evade" payment of the prepayment premium, the lender can enforce the prepayment premium.

Holdings:

- Because the mortgage contained a provision that required payment of the make whole either before or after acceleration: "It imposes the make-whole premium in connection with any *payment* made after an Event of Default, not just a *prepayment* made after an Event of Default but before acceleration."
- "As a result, the Yield Maintenance Default Premium must be analyzed as a liquidated damages provision. Whether a clause which prescribes liquidated damages is in fact an unenforceable penalty is a question of state law."
- The party seeking to avoid the liquidated damages clause bears the burden of proving that it is a penalty and must demonstrate either that the damages flowing from prepayment were readily ascertainable at the time the parties entered into the lending agreement or the prepayment premium is 'conspicuously disproportionate' to the lender's foreseeable losses.
- *Question: how does this square with 502(b)(2) and Ultra?*

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Other Notable Decisions

1141 Realty Owner LLC (cont.)

- The Court distinguished *Momentive Performance Materials Inc. v. BOKF, N.A.* (*In re MPM Silicones, L.L.C.*), 874 F.3d 787 (2d Cir. 2016) which "concluded that the post-acceleration, post-bankruptcy payment was not an optional redemption because a redemption refers to a pre-maturity payment and '[a] payment made mandatory by operation of an automatic acceleration clause is not one made at MPM's option.' *MPM*, 874 F.3d at 802-3.
  - Here: "The *Loan Agreement* requires the payment of the Yield Maintenance Default Premium with any post-default payment and not only when there is an optional redemption."
  - Thus, it did not matter when or how the default occurred, the debtor was always liable for the make whole payment

Additional considerations:

- Question – if the default was triggered by the bankruptcy or during the bankruptcy would the result have been different?
- The Court carefully parsed *Momentive* in its holding by creating an "out" since *Momentive* and earlier cases did not have loan agreements that had such draconian application of prepayment/make whole provisions.
- The debtor apparently did not do much analysis on the issue of whether the make whole was an unenforceable penalty versus appropriate liquidated damages.
- Holding is more consistent with the Third Circuit's rejection of *Momentive* in *Delaware Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 842 F.3d 247 (3d Cir. 2016) (a bankruptcy filing does not automatically void the make whole premium on account of early redemption of notes).

Other Notable Decisions

Constitutionality of new U.S. Trustee fees
In re Buffets, LLC*, 2019 WL 518318 (Bankr. W.D. Tex Feb. 8, 2019); *In re Cranberry Growers Coop.*, 592 B.R. 325 (Bankr. W.D. Wis. 2018), *appeal filed to 7th Cir. Oct. 24, 2018 (case is briefed and awaiting argument)

- In 2018 Congress approved a new fee schedule that disproportionately affects mid-sixed cases.
- Effective January 1, 2018 the maximum fee was increased from a cap of $30,000 for disbursements over $30 million per quarter, to 1% of quarterly disbursements over $1 million, capped at $250,000. Thus, a debtor that has disbursements of $10 million per quarter would see their fees increase from $13,000, under prior rules, to $100,000.

Issues:
- Whether "disbursements" includes money subject to a "roll up" and cash management scheme.
- Whether reorganized debtor's operating "disbursements" are subject to UST fees when estate remains open to prosecute claims transferred to liquidation trust.
- Whether the fee scheme is constitutional.
- Whether the bankruptcy court has discretion to modify the fee scheme.
- Whether there is a difference between a "tax" and a "user fee"

Holdings:
- "Disbursements" is not a defined terms and should relate to the operating disbursements of the debtor.
- *CranGrow*: the cash management/roll-up mechanism should not constitute disbursements: "it would be inequitable to apply UST fees to Direct Revolver Payments made only because of the need to draw on the Direct Revolver Loan to pay UST fees in the first place. Under this theory, a certain portion of Direct Revolver Payments are not 'disbursements.'"
- *Buffets*: The new fee structure is unconstitutional: "After careful consideration of § 1930(a)(6)(B), this Court holds the amendment unconstitutional as applied to this case due to its lack of uniformity for the first three quarters of 2018. The amendment also cannot be retroactively applied to the Reorganized Debtors for any relevant year. Accordingly, the Reorganized Debtors' motion will be granted. A separate order will be entered."

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Proposed Legislation and Pending Cases

Small Business Reorganization Action of 2019 (S. 1091)

- Elective
- Debtor must file plan within 90 days
- No committee
- Standing trustee, who administers distributions under the plan, and has certain other limited powers
- Court can confirm the plan despite no impaired consenting class
- Largely follows the ABI recommendations

Pending Cases:

- *Mission Product Holdings, Inc. v. Tempnology, LLC* ("Whether, under Section 365 of the Bankruptcy Code, a debtor-licensor's 'rejection' of a license agreement—which 'constitutes a breach of such contract,' 11 U.S.C. § 365(g)—terminates rights of the licensee that would survive the licensor's breach under applicable non-bankruptcy law."), argued Feb. 20, 2019.
- *Taggart v. Lorenzen* (whether a creditor's subjective good-faith that it was not violating the discharge injunction is enough to escape sanction), argument pending.